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BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

In the Matter of)	
)	
PUBLIC UTILITIES COMMISSION)	DOCKET NO. 2018-0088
)	
Instituting a Proceeding to Investigate)	
Performance-Based Regulation.)	

DIVISION OF CONSUMER ADVOCACY'S
SECOND PROPOSAL UPDATE FOR PHASE 2

Pursuant to the Hawaii Public Utilities Commission's ("Commission") Decision in and Order No. 36326, filed May 23, 2019 ("D&O 36326"), Establishing Principles, Goals and Outcomes to Guide Phase 2, Order No. 36388 Convening Phase 2 And Establishing A Procedural Schedule, filed on June 26, 2019 ("Order No. 36388"), and the Commission's January 6, 2020 letter, the Division of Consumer Advocacy ("Consumer Advocate") is filing its second Phase 2 update to its prior proposals ("Second Proposal Update") to implement an expanded form of performance-based regulation ("PBR") in the State of Hawaii.

I. EXECUTIVE SUMMARY.

In its Second Proposal Update, the Consumer Advocate offers further refinements to its comprehensive proposal to integrate the Revenue Adjustment and Performance Mechanisms, including a number of expanded details related to the Consumer Advocate's earlier proposals, while acknowledging that further refinement is expected within its Statement of Position to be filed next month.

The recommended Revenue Adjustment Mechanism continues to rely upon the same earnings sharing mechanism ("ESM") and an index-driven Annual Rate Adjustment ("ARA") to increase Target Revenues for inflation ("I") based upon the Gross Domestic Product Price Index ("GDPPI") with an offsetting productivity ("X") factor of zero, so as to perpetuate revenue increases for business as usual activity in the same manner as the existing capped RAM. However, we have modified and expanded the scope of the exogenous ("Z") factor to include declared emergencies such as the current health pandemic, with provisions for deferral of costs and conditions for recovery of such deferred costs, including the potential for partial recovery in consideration of both utility and customer impacts. The Consumer Advocate is also recommending an expanded Consumer Dividend of approximately double the amount previously recommended, based upon the cumulative value over four years of accelerating ARA relief from June 1 to a January 1 effective date. As before, the Consumer Advocate supports retaining existing cost recovery trackers. To further clarify and document the Consumer Advocate's recommended criteria and procedures, we have proposed new Revenue Balancing and Annual Rate Adjustment ("RBARA") and Major Project Special Recovery ("MPSR") tariffs. The proposed RBARA tariff (CA Exhibit 1) summarizes the

decoupling, annual rate adjustment and exogenous factor processes that could replace the existing RBA and Rate Adjustment Mechanism (“RAM”) tariffs. The newly proposed MPSR tariff (CA Exhibit 5) is intended to formalize and replace the existing Major Project Interim Recovery (“MPIR”) Guidelines, adopting and clarifying criteria for qualification, and recommending evaluative criteria for approval, of special recovery for major projects. Additionally, more detailed administrative procedures are recommended for annual filings to support RBARA and performance incentives and for end of control period processes.

For the performance mechanisms, the Consumer Advocate is advocating for the development of a portfolio of shared savings mechanisms (“SSM”) that are designed in a holistic manner to provide additional earning opportunities for the utility companies that would be encouraging superior utility performance in targeted areas, including existing PIMs. The Consumer Advocate has also recommended a new approach to setting performance targets for reliability and customer service so that these targets are not permitted to decline over time as well as possible regulatory procedures that would facilitate the evaluation of utility performance and the need for modifications, if any, to the incentive mechanisms. The Consumer Advocate has identified two options that both have pros and cons that will hopefully spur further discussion. Whichever option is taken, the Consumer Advocate stresses the importance of the utilities filing not only the relevant performance data for the performance period and the financial rewards or penalties associated with that performance data, but also an explanation of how well the performance mechanisms achieved regulatory goals over the performance period, a discussion of the need for any changes to the performance mechanisms, and a full documentation of why any such changes are warranted. All of this information can then

be used by stakeholders to decide whether to investigate modifications to the performance mechanisms.

II. BRIEF BACKGROUND.

The Consumer Advocate incorporates, by reference, its other filings in this proceeding that lay out a more detailed discussion of background in this proceeding for both Phases 1 and 2. The following is a brief background to this Second Proposal Update.

Consistent with the guidance set forth in D&O 36326 and pursuant to Order No. 36388 at 12, the Consumer Advocate filed its initial comprehensive proposal (“Initial Proposal”) on August 14, 2019. In its Initial Proposal, the Consumer Advocate outlined its proposals on the primary PBR mechanisms that could be integral parts of a comprehensive PBR framework, while addressing the identified PBR issues and each of the key mechanisms discussed in D&O 36326. Then, the Consumer Advocate’s First Updated Proposal, filed on January 15, offered more detailed recommendations for the Z-factor, Consumer Dividend and MPIR Guideline revisions, along with Performance Incentives, reported metrics, scorecards, off-ramps, and preliminary financial modeling that illustrated ranges of future financial outcomes expected from its recommendations.

The Consumer Advocate has participated in the various workshops and subgroup meetings and has considered questions and comments raised related to its Initial and First Updated Proposals and has continued to refine and modify its proposals to include more details and improvements in the proposed positions. Order No. 36388 recognized the impossibility of specifying in advance the many detailed parameters for an MRP, ESM,

portfolios of performance mechanisms and the other terms of a comprehensive PBR framework:

These proposals should be comprehensive and address the key mechanisms discussed in D&O 36326, including a proposed annual revenue adjustment formula, ESM, any proposed updates to the MPIR adjustment mechanism, potential off-ramp mechanism, process addressing the end of the initial 5-year MRP, and a suggested portfolio of performance mechanisms. That being said, at this stage, the Parties may not yet be able to specify all relevant details in their proposals for different revenue adjustment and performance mechanisms, and those proposals can thus be submitted with the understanding that the Parties will submit subsequent, further refined proposals as Phase 2 proceeds, incorporating amendments and additional details in response to feedback from the Working Groups. This iterative process is intended to ensure that the Parties explore, test, and improve their respective proposals prior to their final submission to the commission.¹

The Consumer Advocate has also strived to use the series of workshops and Subgroup meetings convened to date to consider and discuss the diverse and creative recommendations contained within the Parties' Updated Proposals for Multi-year Rate Plan ("MRP") inputs, Performance Incentive Metrics ("PIM") parameters, ESM calibrations, MPIR modifications and other details. Consistent with the Commission's guidelines that were offered, this Second Proposal Update provides more detailed specification of a number of important aspects, including the Consumer Advocate's recommended MRP inputs for exogenous events and customer dividends, refined PIM/SSM proposals, more specific ESM and MPIR modifications along with updated financial forecast modeling supportive of these recommendations, and proposed procedures that might be used to process the anticipated MRP and PIM filings.

¹ Order No. 36388 at 12.

Notably, in developing its recommended ARA framework, the Consumer Advocate's Second Proposal Update continues to propose only modest changes to the existing RAM that is capped so that target revenue increases do not exceed general inflation, as measured by GDPPI. This is appropriate so as to achieve the affordability and cost control goals and the customer-centric and administrative efficiency principles adopted by the Commission in Order No. 36388, while recognizing that the capped RAM element of the existing regulatory framework has been working largely as intended. This approach recognizes the extensive effort already invested in the design and administration of the existing RBA, RAM, ESM, and MPIR mechanisms through Docket Nos. 2008-0274 and 2013-0141 and the many subsequent decoupling transmittal issues and outcomes. The Consumer Advocate continues to recommend careful and deliberate incremental changes to the existing regulatory framework that are designed to achieve the Commission's stated goals for Performance Based Regulation, while not exposing the utilities or their ratepayers to unreasonable risks and unacceptable outcomes.

In addition, the Consumer Advocate has continued to modify its performance incentive mechanisms proposals to provide strong support for the benefits that would be expected for both customers and the utility companies through SSMs and to continue its recommendation to develop well-defined metrics to improve the monitoring of the utility companies' performance in the key outcome areas that have been identified.

III. REVENUE ADJUSTMENT MECHANISM.

In this Second Proposal Update, the Consumer Advocate continues to observe that the existing RAM, with an annual cap on increases to target revenue between rate cases limited to changes in the GDPPI, has worked well and has achieved a reasonable balancing of shareholder and ratepayer interests, when viewed in the context of the many other cost recovery mechanisms available to the utilities to supplement utility revenues. The existing capped RAM constrains target revenue growth available to fund the utility's "business as usual" activities to the rate of general inflation as measured by GDPPI, while allowing additional "above-inflation" revenue increases to support Commission-approved transformative projects through the MPIR, Renewable Energy Infrastructure Cost Recovery Provision ("REIP") and Integrated Resource Planning Cost Recovery Provision ("IRP/DSM" surcharge). Additionally, the utilities' largest, most volatile and less controllable costs of fuel and purchased power are recovered through separate Energy Cost Recovery Clause ("ECRC") and Purchased Power Adjustment Clause ("PPAC").

Additionally, the RBA decouples utility sales volumes from revenues, insulating the utility from the risks of revenue fluctuations and declining sales trends. The financial value of revenue decoupling to utility financial performance has been amplified by recent COVID-19 pandemic impacts, stabilizing utility revenues, and highlighting the effect of translating declining energy sales volumes into future rate increases that stabilize earnings while placing additional burdens upon customers. The Consumer Advocate continues to recommend in its Second Proposal Update that the Commission conclude that these existing mechanisms (ECRC, PPAC, RBA, MPIR, REIP, IRP/DSM) and the general processes that are used to implement these pieces of PBR should continue to be

part of the new PBR framework in spite of these anticipated adverse customer impacts² since the mechanisms will facilitate achievement of the identified outcomes. Efforts should be made, however, to moderate consumer impact by increasing the focus on delivering value and benefits to consumers and ensuring a reasonable balance between utility and consumer impacts.

In this Second Proposal Update, the Consumer Advocate continues to support, as a backstop to protect the interests of both shareholders and customers, utilization of a symmetrical ESM to serve as financial guardrails, mitigating any material over- or under-earnings produced by the consortium of mechanisms, clauses and trackers. The implementation of a symmetrical earnings sharing mechanism is a modification to the existing earnings sharing mechanism that has been a part of RBA/RAM ratemaking and that should be preserved as the foundation for the MRP approved by the Commission in Phase 2, as more fully discussed herein.

In its Initial and First Updated Proposals, the Consumer Advocate noted that significant administrative simplification should result from a reasonably designed PBR enabling the redirection of substantial resources now being invested in general rate cases toward administration of new incentive mechanisms, ongoing planning and rate design dockets and facilitation of more rigorous reviews of important cost tracking mechanisms. Periodic financial and management audits of the ECRC should now be possible, along

² The content and timing of utility filings and the regulatory review and dispute resolution processes needed to administer the existing portfolio of revenue adjustment mechanisms, along with any revised revenue adjustment mechanisms, performance incentives and earnings sharing will require careful analysis and determination as clarity is gained regarding the changes to be imposed in this docket. Only very preliminary recommendations are described herein, with the goal of initiating the discussion of regulatory review processes.

with more intensive reviews of the PPAC and increasingly complex MPIR utility applications. With installation of a symmetrical ESM, the Commission should also anticipate the need to redirect more resources in the future to regulatory analysis and oversight of annual reported earnings calculations that will drive administration of ESM and an expanded portfolio of performance incentives.³ The results of ESM and incentives will prospectively serve a much more important role in Hawaii regulation, justifying a conscious effort to simplify regulation elsewhere so that filed calculations supporting the annual ESM and RBA, and added performance incentives and ARA receive appropriate regulatory attention. In this Second Proposal Update, the Consumer Advocate includes more detailed prescription of recommended periodic filings and review procedures needed to administer the Consumer Advocate's recommended MRP, incentives, and the continuation of the other existing cost recovery mechanisms for decoupling, fuel, purchased power, and Commission-approved project costs recoverable through MPIR.⁴ The Consumer Advocate hopes that this will spur needed discussion on how the proposed mechanisms will be administered.

³ It should be noted that, within the context of the Consumer Advocate's discussion of revenue mechanisms, the reference to "PIMs" is meant to refer to any performance incentive mechanism that may be adopted by the Commission and is not meant to exclude reference to SSMS, scorecards, or other performance incentive related mechanisms.

⁴ As mentioned in its first update, detailed discussion on possible processes were withheld since, depending on the mechanisms adopted by the Commission, a hypothetical process developed for a particular set of mechanisms may not be a good fit for different mechanisms. Thus, it should be made clear that the recommended processes described herein are specific to the Consumer Advocate's proposed PBR mechanisms and that, if other mechanisms or other forms of the mechanisms are adopted, different processes may be required. As such, the Consumer Advocate reserves the right to offer additional modifications and comments on certain processes, even the ones that have been proposed by the Consumer Advocate, if necessary and appropriate.

As part of this Second Proposal Update, the Consumer Advocate had drafted a proposed Revenue Balancing Account and Annual Revenue Adjustment (“RBARA”) tariff that is included as Exhibit 1. The RBARA is designed to consolidate the existing decoupling mechanism with the proposed new Annual Revenue Adjustment formula, while also documenting exogenous Z-Factor criteria and procedures along with earnings sharing procedures. The proposed RBARA tariff is a draft of language that could replace the existing RBA and RAM tariffs in place at each utility and assumes adoption of Consumer Advocate positions described herein. Revisions to the RBARA would, of course, be required after the issues addressed within the RBARA have been resolved by the Commission.

A. DEVELOPMENT OF MRP INPUTS.

1. Introduction.

In Phase 1, the Commission adopted a five-year MRP with an index-driven ARA formula, continuation of the existing revenue decoupling mechanism, a symmetrical ESM, continuation of fuel, purchased power, and major project cost tracker mechanisms and off-ramp provisions.⁵ These conceptual elements were addressed in increasing levels of detail within the initial and first updated proposals filed by the Consumer Advocate, the utilities and the other parties. Subsequently, the parties discussed the proposals and conceptual elements in the series of planned workshops and working subgroup meetings, where a narrowing of differences appears to have occurred for certain elements. In this

⁵ D&O 36326 at 26 et seq.

Second Proposal Update, the Consumer Advocate presents additional refinements to its previous submissions in the discussion that follows.

2. Discussion of MRP Inputs.

After careful consideration of comments and alternative recommendations presented by the Hawaiian Electric Companies and other Parties, the Consumer Advocate remains supportive of only gradual movement away from the existing multi-year rate plan that has served the Companies and ratepayers well over the past several years. In apparent reference to the existing MRP in place in Hawaii, D&O 36326 indicates that, "...the development of a five-year MRP represents a reasonable step towards transitioning to a longer control period between rate cases, providing the utility with an operational environment similar to a competitive market structure. This structure can provide incentives to manage costs over a longer period of time; if the Companies can lower costs during the control period, they will increase their earnings."⁶ The Consumer Advocate's recommendations set forth below regarding inflation, productivity, customer dividend and exogenous adjustments and the processes recommended at the end of the control period are designed to be consistent with the Commission's philosophy of employing "reasonable steps towards transitioning" while controlling the risks of unintended consequences. More dramatic changes to the existing MRP have been recommended and presented in workshops but the Consumer Advocate does not believe that those more dramatic changes have been demonstrated to be prudent or justified at this time.

⁶ Id.

B. INFLATION AND PRODUCTIVITY.

In its Phase 1 Decision & Order, an Index-Driven Revenue Formula Index was approved by the Commission, where revenues during the five year control period will be determined by a combination of ARA (with a revenue index formula, performance incentives and cost trackers).⁷ The ARA approved in D&O 36326 would replace the existing RAM and RAM Cap revenue adjustment provisions by adjusting utility revenues by the following index-driven formula:⁸

$$\text{Annual Revenue Adjustment} = (\text{I Factor}) - (\text{X-Factor}) + (\text{Z-Factor}) - \text{Consumer Dividend}$$

The Consumer Advocate continues to support replacement of the traditional RAM and RAM Cap mechanism with a simplified ARA in the form of the approved Index-Driven Revenue Formula. Although the Commission has not yet adopted a specific inflation factor, the Staff Proposal referenced the GDPPI for inflation and a “fairly narrow range” of expected base productivity trends, while also recommending a “Consumer Dividend” feature to “ensure that there is some “pay-off” for customers to ensure that rates are lower than otherwise, even if they are increasing due to inflation exceeding productivity.”⁹ This approach appears to have been approved by the Commission in D&O 36326¹⁰ and

⁷ D&O 36326 at 26-27.

⁸ *Id.* at 29-30. X-Factor: Predetermined annual productivity factor; Z-Factor: Factor applied (ex post) to account for exceptional circumstances not in the utility’s direct control (e.g., tax law changes); and Consumer Dividend Factor: A “stretch factor” or reduction in allowed revenues.

⁹ Staff Proposal at 26-27.

¹⁰ D&O 36326 at 30-31.

GDPPI has emerged as the presumptive inflation measure being adopted by all other Parties. The Parties have not, however, similarly coalesced around common values or approaches to be used for Z, X, and the Customer Dividend.

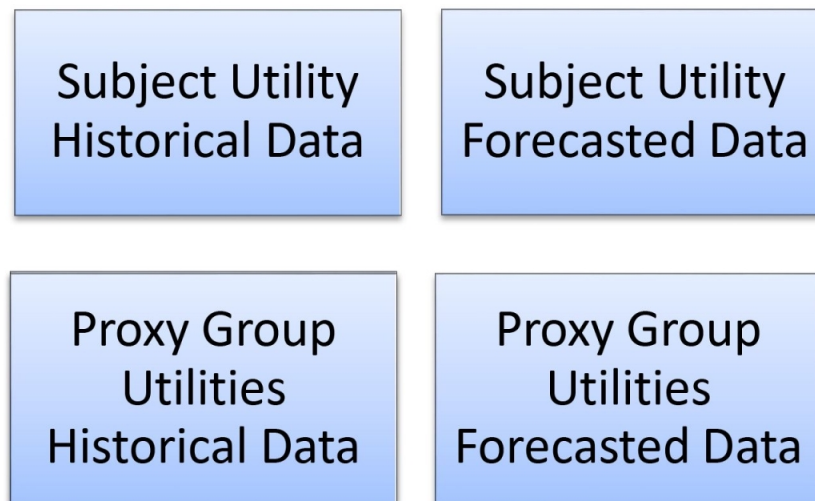
In its previous filings, the Consumer Advocate noted that the Hawaiian Electric Companies have been operating under a functioning MRP now in place that has served as a reasonable step away from traditional regulatory practices. Through the operation of the existing MRP with a capped RAM, the Commission has established a reasonable balancing of consumer and utility interests. Again, in this Second Proposal Update, the Consumer Advocate recommends retention of the inflation and productivity parameters employed within the existing RAM unless more valid updated inputs are proven to better serve the public interest. This approach provides a default value for the ARA inflation index (the “I” factor) using the existing GDPPI consensus forecast that should be continued prospectively. Since the GDPPI is publicly available, readily accessible, and there appears to be an emerging consensus across the Parties’ proposals to adopt GDPPI as the “I” value, the Consumer Advocate urges the Commission to avoid adopting alternative inflation surrogates that may create significant administrative work with little corresponding increase in value or accuracy.

The existing RAM Cap is tied to GDPPI with no productivity offset, such that continuation of the terms within the Companies’ existing MRP would also imply an assumed default productivity (the “X” factor) value of “zero”.¹¹ The Consumer Advocate

¹¹ In fact, there is likely some level of embedded economy-wide productivity gains within the GDPPI values. On the other hand, the traditional RAM calculation applied a 0.76 percent labor productivity offset to wage rate increases, assuming the Companies can achieve favorable productivity gains.

continues to support utilization of GDPPI for the I factor and zero for the X factor, as was advocated in its previous filings.

Four approach options are available to evaluate alternative I and X inputs for use in formula-based ratemaking under the ARA. A choice between historical or projected financial data is involved, and then either the subject utility's financial information or sample "proxy" utility financial information can be relied upon to evaluate and help calibrate these ARA inputs.



Unfortunately, these options all suffer from theoretical and practical limitations. Reliance upon historical data, either for the subject utility (i.e., the Hawaiian Electric Companies) or a selected proxy group (e.g., vertically integrated electric utilities) inherently assumes that history can reasonably be expected to predict future outcomes.

Excessive reliance upon the subject utility's own historical data implies an assumption that past recorded performance is reflective of acceptable or targeted future levels of management efficiency and cost control, even though improved future cost control is a priority outcome for PBR regulation. The Hawaiian Electric Companies have

lived within a GDPPI with zero “X” environment between rate cases historically. Adopting any negative “X” productivity input for the Companies, regardless of its source, invites less rigorous utility cost-control performance than was expected under the existing capped RAM approach and is inconsistent with the outcomes expected from future Performance Based Regulation.

Reliance upon historical cost trends of selected proxy utilities is also problematic, given the uncertainties around how different regulatory regimes, geographic conditions or operating environments within other jurisdictions may influence mainland utility management behavior. Additionally, the criteria applied to first select “comparable” mainland utilities and then adjust their data to improve comparability introduces complexity and potential bias. An insurmountable problem occurs when some of the infrastructure modernization, environmental and other programmatic costs incurred by proxy-group utilities have been treated as separately recoverable through regulatory surcharges in other jurisdictions, similar to Hawaii’s MPIR and REIP mechanisms, and therefore are not properly includable in estimation of “X.”

Forecasted financial data, on the other hand, would appear to be a conceptually more desirable basis for benchmarking inflation and productivity inputs for the ARA. We are, after all, designing PBR elements for application in future periods. However, considerable judgment is required to produce even short-term financial forecasts and the uncertainty surrounding optimal forecasting assumptions for the Hawaiian Electric Companies over multiple future years is amplified by the multiple transformational issues and evolving grid planning and market structure issues unique to and singularly impacting the Hawaii utilities. The Commission and Consumer Advocate have considerable

experience with the issues that arise when only single “test year” financial forecasts filed by the utility are vigorously debated in traditional rate cases, where millions of expense and rate base dollars are routinely adjusted downward from utility-forecasted levels in the determination of the revenue requirements ultimately approved by the Commission.¹² When longer term multi-year forecasts for the Hawaiian Electric Companies are attempted within the evolving transformational environment in Hawaii, the challenges of accurately predicting future financial outcomes become insurmountable and only wide ranges of potential outcomes are predictable. Alternatively, forecasted financial data for potential proxy utilities is generally not publicly available and would suffer from the same problems noted above with respect to proxy utility historical information.

The Consumer Advocate has evaluated forecasted cost/price trend data for proxy utilities or the overall electric utility industry but has not found any compelling information that supports a possible mechanism that should be adopted. The U.S. Energy Information Administration publishes an Annual Energy Outlook report annually, the latest of which was dated January 29, 2020, that includes projections of national energy

¹² For example, in HELCO Docket No. 2018-0368, the utility requested an increase over currently effective revenues of \$13.7 million, but after partial settlement asserted need for a net interim increase of \$2.7 million, while the Consumer Advocate recommended that the Commission approve an interim decrease of \$2.9 million. The Commission found a zero net interim increase to be reasonable in Interim Decision and Order No. 36761.

In Docket No. 2017-0150, MECO requested approval of an increase over currently effective rates of \$30.1 million, which increased to \$46.6 million when higher Commission-approved depreciation accrual rates were included. In Order No. 36323, the Commission approved jointly filed tariffs dated April 17, 2019, in that Docket that would produce a \$12.2 million increase in revenues above currently effective rates, as calculated in Exhibit 1C in that joint filing.

In the currently ongoing Hawaiian Electric Docket No. 2019-0085, the Company requested an increase over currently effective rates of \$77.6 million.

production and consumption through 2050 with a section dedicated to “Electricity”.¹³ The reference case projections within that report show national average electricity prices falling slightly through 2050, with declining generation costs offset by rising transmission and distribution costs.¹⁴ When the reference case data for these EIA projections is downloaded and analyzed, the near-term compound average annual growth rates from 2020 through 2025 for projected nationwide electric generation, transmission and distribution service prices are 1.9 percent, 3.6 percent and 3.5 percent, respectively.¹⁵ These low percentage growth rate values suggest national average utility cost of service trends to be near or slightly above expected general inflation, as measured by GDPPI. There is no direct applicability of the EIA national projections of utility costs and prices to the Hawaiian Electric Companies, because the drivers of utility cost trends on the mainland are heavily dependent upon different resource mixes, fuel prices and operational issues than are expected in Hawaii – similarly, the rate adjustment mechanisms that allow recovery of authorized revenues and changes in costs is different in Hawaii than on the mainland. However, these values suggest that the combination of ARA, MPIR and REIP price increases within the Consumer Advocate’s recommended MRP, when combined with opportunities for performance incentives under PBR and potential revenue growth from innovative new products and services, will produce

¹³ Available at: <https://www.eia.gov/outlooks/aeo/pdf/AEO2020%20Full%20Report.pdf>.
Electricity excerpt at: <https://www.eia.gov/outlooks/aeo/pdf/AEO2020%20Electricity.pdf>.
Assumptions are available at: <https://www.eia.gov/outlooks/aeo/assumptions/pdf/electricity.pdf>.

¹⁴ Id, page 74.

¹⁵ Download information is available in Excel at: https://www.eia.gov/outlooks/aeo/tables_ref.php
Select Table 8.

sufficient revenue growth to compensate the Companies if their future costs to provide service rise at the approximate pace of projected national average cost/price trends.

Given the difficulties in relying upon proxy group studies and published averages, the Consumer Advocate continues to focus its analysis upon historical achieved earnings data for the Hawaiian Electric Companies under the existing capped RAM. This analysis supports a conclusion that the existing RAM, with target revenue increases capped at GDPPI, and with a zero productivity offset, adding targeted revenue increases separately granted through the MPIR and REIP mechanisms, has produced consistently adequate but somewhat below authorized levels of return on average common equity:

Achieved Return on Equity	2016	2017	2018	2019	Average
Hawaiian Electric Company	9.45%	6.82%	8.02%	8.82%	8.28%
Hawaii Electric Light	7.61%	7.29%	8.36%	6.72%	7.50%
Maui Electric Company	8.34%	6.83%	7.54%	7.96%	7.67%
Average	8.47%	6.98%	7.97%	7.83%	7.81%
All Amounts taken from filed Decoupling Templates, Schedule H					

The Consumer Advocate continues to view these results as validating use of GDPPI for “I” and zero for “X” as the most appropriate inputs for the ARA prospectively, noting that the Companies will have several new opportunities to meaningfully improve upon achieved return on equity (“ROE”) levels under performance-based regulation, by growing revenues and improving cost controls while achieving incented performance, rather than by more aggressively increasing future ARA increases charged to ratepayers. These opportunities include:

- Self-help cost control measures that are more aggressively promoted and rewarded under the MRP.¹⁶
- New revenues from sale of non-traditional products and services through planned Marketplace initiatives, ownership of historically jointly-owned utility poles, privatization of military utility system, and electrification of transportation.
- Performance incentives, that could increase ROE by up to 200 basis points under the Consumer Advocate's Second Proposal Update.¹⁷

The combined impact of these changes can be expected to improve upon historically achieved returns noted previously, assuming the Companies successfully respond to the performance incentives and new revenue opportunities being made available. And, if the utilities fail to successfully respond and future earnings instead decline from historical levels, the ESM mechanism described herein, if necessary, will ensure financial integrity is not jeopardized.¹⁸

Later in this Second Proposal Update, the Consumer Advocate again presents the financial modeling that was performed in the First Proposal Update by the Consumer Advocate to validate utilization of GDPPI and zero productivity factors as

¹⁶ Cost control is a targeted regulatory outcome desired under PBR regulation. For example, management constraints on the growth in costs relative to I-factor revenue escalation can produce beneficial self-help outcomes.

¹⁷ See discussion in section IV. E.

¹⁸ As will be discussed later, the Consumer Advocate's proposed PBR framework is predicated upon the amount of additional revenues that might be earned through the PIMs or SSMS as additive to the Commission approved return on equity. Thus, assuming no positive or negative impact from PIMs, the utility still has the opportunity to earn its Commission's approved ROE and the PIMs and SSMS reflect an opportunity to increase its earnings – subject to other ratemaking mechanisms such as the ESM.

inputs to ARA, across a range of input scenarios for each utility, with the results processed through the ESM that is described herein. When examined either through historical ROE performance or reasonably projected financial outcomes with symmetrical ESM applied, the use of GDPPI for I and zero for X appears reasonable.

To date, the Consumer Advocate believes that there has been no credible showing that an appropriate productivity input applicable to the Companies is a negative value. The Initial and First Updated Proposals submitted by the Hawaiian Electric Companies advocated for a specific negative X value, relying upon a “simplified Kahn Methodology, as calculated by PEG” based upon an analysis of sample financial data for 45 U.S. vertically integrated utilities and a selection of a 15-year average which produced an X factor of negative 1.41 percent “pending further evaluation of the X-factor and financial analyses of the MRP proposals.”¹⁹ The Consumer Advocate’s continuing review of this proposal indicates that the MPIR and REIP cost recovery mechanisms available to the Hawaiian Electric Companies, if assumed to have been available to the 45 utilities in the PEG analysis, would obviate the need for any significant negative productivity factor within a price index form of regulation. Additionally, the sampled utilities have experienced costs within the analysis period to add traditional generating resources, to install environmental retrofits of existing fossil generation, and to significantly expand

¹⁹ Initial Comprehensive Proposal of the Hawaiian Electric Companies at 19-20. HECO Updated Comprehensive Proposal at 24. The same analysis would support an X factor of -1.04% over the full 1997-2017 sample period or a more than doubled negative X factor of -2.35% if the results for only the last 10 years (2008-2017) are selected. It is the Consumer Advocate’s understanding that revisions to this study are planned to be adopted by the Companies, to correct for identified errors in the original PEG study. Workpapers for the Companies’ “updated” X-Factor calculation were filed on April 3, 2020 in Docket No. 2018-0088.

interstate transmission facilities - all extraordinary costs that could be either be recovered through Hawaii's MPIR mechanism or that will not be needed in Hawaii.²⁰

Blue Planet Foundation included an alternative study of the historical average change in non-fuel revenues for 55 vertically integrated electric utilities ("VIEUs") over the 24 years of 1994 to 2024. This analysis observed that, "...a simple subtraction of the average GDP-PI of 1.9% from the average nominal increase in utility non-fuel revenues of 3.01% indicates an average real change in non-fuel revenues of 1.11%."²¹ However, instead of concluding that a negative X value of -1.11 percent is needed, Blue Planet acknowledged that, "[t]his figure, again, offers only an initial step, reflecting an "all-in" measure of historical revenues, including major projects that, under a PBR regime, would be covered in a major projects recovery mechanism – or specifically in Hawai'i, the MPIR. To provide a more complete and accurate picture of the X-Factor, this figure must still be adjusted to account for major project costs that would be recovered separately and, thus, should not be included and "double counted" in the X-Factor figure."²²

In an effort to improve its analysis, Blue Planet "...modeled the cost recovery implications of an MPIR-like mechanism in relation to the capex surges seen in the data. The model assumes that, in any year in which the capex exceeded the trended average capex by 50%, an MPIR-like adjustment was made to revenues."²³ Subtraction of a

²⁰ A series of specific requests submitted by the Consumer Advocate seeking additional data regarding data underlying the PEG Report and related analyses were answered on January 6, 2020, and appear to confirm the concerns described herein. The Consumer Advocate's review of the PEG Report is ongoing.

²¹ Blue Planet Foundation's 1st Proposal Update at 5-7.

²² Id. Page 7.

²³ Id. Page 9.

calculated “Capex/MPIR Adjustment” of 1.08 percent from the “all-in” measure of historical revenue trends yields a negligible net productivity value of 0.04 percent.²⁴ The Consumer Advocate understands that Blue Planet intends to expand and update this analysis from comments offered in a Revenue Working Group workshop session, but in its present form Blue Planet’s work tends to support use of a zero “X” value within the ARA.

The diversity of results comparing the Companies’ and Blue Planet’s work illustrates how the selection of proxy-group companies, the period of review, the methods employed and whether or not one recognizes the potential for MPIR and REIP revenues to provide recovery for certain costs can dramatically impact the resulting proposed X factor values. The Consumer Advocate intends to continue to evaluate these proposals but, as discussed above, believes that if such proposals were adopted, it would introduce bias and complexities to develop the X factor that should be avoided. Furthermore, the adoption of the proposed techniques appear to be inherently biased towards adopting a negative productivity factor, which would be contrary to the efforts to impose cost control discipline as well as the intuitive expectations associated with the anticipated investments in new technologies and processes that are expected to **reduce**, not increase, the utilities’ net costs.

As pointed out herein, adoption of any negative productivity value would unfavorably impact the affordability regulatory outcome targeted in this proceeding, by locking in higher future target revenues than would occur under the existing capped RAM form of regulation. Any negative productivity value for X could effectively negate the

²⁴ Id. Table at page 10.

Customer Dividend intended by the Commission to result from adoption of PBR regulation. As a point of reference, every 100 basis points (one percent) of negative productivity within the Annual Revenue Adjustment would increase the revenues of the utilities by approximately \$9.7 million annually, which would significantly erode affordability if applied sequentially over the entire control period of the MRP.²⁵ Assuming adoption of a significant negative X value, the Consumer Advocate would question the advisability of permitting additional Major Project cost recoveries under MPIR, since the revenues provided by negative productivity may be redundant to incremental costs now recoverable through the MPIR.

The Hawaiian Electric Companies should be encouraged to rely upon and emphasize cost-control, new revenue opportunities, MPIR, and achievement of performance incentives to improve earnings, rather than burdening customers with higher prices unrelated to improved performance, via a negative productivity assumption. Performance based regulation is designed to shift the focus of regulation away from cost of service regulation (“COSR”), that systematically rewards higher costs with higher rates, and toward a price path independent of cost trends; rather, PBR should be: 1) encouraging aggressive management of costs and the pursuit of elevated efficiency, 2) enhancing performance relative to established metrics and baselines to earn incentives, and 3) development of new services and sources of revenue, as described herein.

Notably, the Companies have already commenced the systematic review and reengineering of business processes to reduce costs under the “One Company” initiatives

²⁵ Based upon proposed Target Revenue Amounts stated in RBA transmittals filed March 31, 2020 by HECO, HELCO and MECO of \$660 million, \$157 million and \$155 million respectively, or \$972 million collectively, times one percent.

that are enabled by large investments recently made in Enterprise Resource Planning / Enterprise Asset Management (“ERP/EAM”) automated systems. Significant incremental productivity gains are expected to result from these initiatives and investments in the immediate future.²⁶ New future revenue sources are being developed through efforts such as electrification of transportation programs, utility ownership of joint poles and new marketplace initiatives explained in Hawaiian Electric’s rate case evidence²⁷ as well as the new opportunities to earn performance incentive revenues being recommended by the Consumer Advocate.

For all of the reasons stated herein, the Consumer Advocate continues to support utilization of GDPPI for the I factor and zero for the X factor, combined with: 1) Customer Dividends, 2) an expanded exogenous Z-factor, 3) clarified MPIR qualification and evaluation criteria, and 4) the application of the proposed symmetrical ESM, as more fully described below. The Consumer Advocate’s related recommendations described herein for MRP inputs, MPIR modification, ESM, changes to accelerate the annual effective date of ARA increases to January 1 and to annualize the first year return element of MPIR revenues, as proposed by the Hawaiian Electric Companies and discussed below, should also be approved by the Commission.²⁸ Collectively, these modifications, changes and

²⁶ HECO-102 filed with Company direct testimony in Docket No. 2019-0085 summarizes 21 pages of O&M and Capital Cost Containment, Productivity/Efficiency, Cost Avoidance and Other Measures with estimates of the savings achieved, all in the context of existing regulation before adoption of new PBR incentives.

²⁷ See Exhibits HECO-1109, HECO-1307, HECO-1308, HECO-WP-1304 and HECO-WP-1106 in pending Docket No. 2019-0085 for additional information.

²⁸ Initial Comprehensive Proposal of the Hawaiian Electric Companies at 14 and 27. Accelerating the effective date of ARA increases is proposed to help fund a larger Customer Dividend. Annualizing the return on MPIR capital investments in year one mitigates earnings attrition otherwise caused by the cessation of AFUDC when new assets are placed into service.

recommendations beneficially support the use of a GDPPI based I factor and zero X factor.

The draft RBARA tariff within Exhibit 1 adopts GDPPI and zero within the Annual Revenue Adjustment portion of the tariff and with no offset for prospective Consumer Dividend reductions to the ARA, in favor of the one-time bill credits described below.

C. CONSUMER DIVIDEND.

A Consumer Dividend is anticipated and necessary upon adoption of PBR, pursuant to D&O 36326, “[c]onsistent with the Principle of adopting a customer-centric approach, including a Consumer Dividend will help ensure that ‘day-one’ savings for utility customers are realized.”²⁹ There is no Consumer Dividend within the existing RAM Cap, so this entirely new value must be established to provide customer value on “day-one” and to serve as an early delivery for some of the assumed productivity gains stimulated by the expanded MRP and already anticipated or committed by the Companies from other productivity initiatives, such as the many listed cost containment and efficiency measures identified in the Hawaii Electric Light proceeding awaiting a final decision and order and the pending Hawaiian Electric rate case.³⁰

In its First Proposal Update, the Consumer Advocate recommended a Consumer Dividend in the form of one-time bill credits to customers on a date soon following initiation of regulation under the new PBR framework, totaling \$11.1 million to Hawaiian Electric’s

²⁹ D&O 36326 at 31.

³⁰ Summarized in HELCO-113 in Docket No. 2018-0368 and multiple exhibits in Docket No. 2019-0085 (HECO-303, HECO-714, HECO-1004, HECO-1104, HECO-1201, HECO-1304, HECO-1404, HECO-1504A/C/D and HECO-1715).

customers, \$2.7 million to the customers of Hawaii Electric Light, and \$2.7 million to customers of Maui Electric. These bill credit amounts were based upon two times the estimated value of accelerating ARA revenue increases from the June 1 date now used for annual RAM increases to January 1 of each year. In this Second Proposal Update, based on comments received, the Consumer Advocate proposes to approximately double the Consumer Dividend, based upon four times the approximate cumulative revenue “value” of accelerating ARA recovery from the currently effective June 1 date under the existing capped RAM to an earlier effective date of January 1 when the simplified ARA is proposed to become effective.

The Hawaiian Electric Companies have proposed earlier annual filings of the ARA, in time for increased Target Revenues to be effective as of January 1 of each year.³¹ Accelerating the accrual date for ARA to January 1 from the existing June 1 RAM effective date has value to the Companies but has a financial impact on consumers. The Consumer Advocate is amenable to this change assuming, however, Commission approval of the Consumer Advocate’s other recommendations set forth herein. Since the proposed acceleration will produce an annual revenue benefit to the utilities at ratepayers’ expense, the Consumer Advocate’s proposal was designed to provide some quantifiable means of supporting a customer dividend amount – as opposed to an arbitrarily set value. Under the Consumer Advocate’s approach to Consumer Dividend quantification, it is assumed that the ARA acceleration produces sufficient cumulative incremental revenues

³¹ Initial Comprehensive Proposal of the Hawaiian Electric Companies at 3 and 43.

over four years, in 2022 through 2025, to fully advance “fund” the dividend to customers.³² In return for advance receipt of the dividend as a one-time bill credit, customers will gradually “pay back” their advanced dividend through the annual acceleration of ARA rate increases through the decoupling mechanism, over the initial term of the control period. A calculation of the Consumer Advocate’s revised proposed Consumer Dividend is set forth in Exhibit 2.

D. Z-FACTOR EXOGENOUS CHANGES.

A provision for exogenous changes (“Z-factor”) was also adopted by the Commission within the ARA formula, which is intended to function when, “...uncontrolled exogenous events affect a utility’s costs.”³³ In its Initial and First Updated Proposals, the Consumer Advocate supported inclusion of a carefully and very narrowly defined exogenous factor that would permit single-issue target revenue adjustments to address clearly extraordinary events, such as tax law changes, named storms and other catastrophic events exceeding a threshold dollar impact. The utilities’ existing MRP contains an example of a single exogenous factor basis for adjustment, within the RAM tariff, where a provision for “exogenous tax changes” is specified for Hawaiian Electric Company as, “The Exogenous Tax Changes shall be the changes in tax laws or

³² It is assumed that the Commission’s Order to implement PBR, after panel hearings now scheduled for September 21-25, with briefing and deliberation thereafter, will not enable ARA acceleration by January 1, 2021, but would enable the accelerating of annual ARA increase by January 1, 2022.

³³ Staff Proposal at 27.

regulations that are estimated to impact RBA Target Revenues by two million dollars (\$2,000,000) or more.”³⁴

In this Second Proposal Update, the Consumer Advocate continues to emphasize the importance of constraining any Z-factor adjustment to address only major changes that are clearly beyond the control of management, that have a significant impact on the utilities’ financial condition that cannot be reasonably handled without extraordinary changes to target revenues, and should be consistent with the factors normally required by the Commission when evaluating whether a single-issue ratemaking request is reasonable.³⁵ If vaguely defined or overly permissive Z-factors are enabled, controversy would be invited around any number of events that could be cherry-picked and said to qualify for exogenous rate relief, which may derail the intended outcomes of PBR.

Since the First Updated Proposal was submitted, the impact of COVID-19 on individual, business, and utility financial interests has caused the Consumer Advocate to now propose expanding the scope of the Z-Factor to clearly include Federal and State declared emergencies, as emphasized by the ongoing pandemic disruptions. Based upon its involvement in working group activities, and the State’s recent experience with COVID-19, the Consumer Advocate supports a further expansion of the existing

³⁴ Hawaiian Electric Rate Adjustment Mechanism Provision tariff at Revised Sheet No. 93B. Lower threshold amounts apply for this purpose to Hawaii Electric Light and Maui Electric.

³⁵ The Commission has consistently denied utility requests for recovery of costs that were indicative of single-issue ratemaking. Generally, the Commission only allowed exceptions when certain factors were present, such as the results of the event or costs not included in base rates were of significant magnitude as it might threaten financial viability and were events that were beyond the control of the utility. See, e.g., Decision and Order No. 19177, filed on January 31, 2002, in Docket No. 01-0252, at 3 – 4; Decision and Order No. 13545, filed on September 7, 1994, in Docket No. 94-0021, at 3 – 5; Decision and Order No. 13572, filed on September 22, 1994, in Docket No. 94-0045, at 3 – 4; and Decision and Order No. 33178, filed on September 29, 2015, in Docket No. 2014-0113.

exogenous Z-factor to also provide cost recovery for extraordinary non-labor expenses incurred and return of new capital invested to quickly restore service after named storms, catastrophic events and other actions to respond to other declared emergencies, where incremental incurred costs exceed the proposed expanded dollar threshold amounts.

The details of these changes are set forth within the Consumer Advocate's draft proposed RBARA tariff within Exhibit 1. The Consumer Advocate's draft RBARA tariff expands the proposed language modifying the existing exogenous Z-factor tariff language for these purposes and would permit deferral accounting above threshold amounts of incremental incurred costs, subject to review and potential approval by the Commission to recover such costs through subsequent ARA revenue adjustments. It should be noted, however, that costs deferred for consideration as Z-factor adjustments should not be assumed fully recoverable from ratepayers and the Commission should consider other facts and circumstances in evaluating claims for Z-factor revenue adjustments, including:

1. Whether utility management acted prudently in response to the event.
2. Whether or not overall utility costs increased when the subject deferred, incremental costs were incurred, because other activities and spending may have been deferred, such that special recovery of the utility's deferred incremental costs is not warranted.
3. Whether there may be other external sources of cost recovery that should reduce the amount that might be recoverable from customers, such sources of cost recovery could include, but is not limited to, federal aid, state aid, and insurance proceeds.

4. Whether a sharing of cost responsibility between shareholders and ratepayers is appropriate, given the nature of the event. For example, in a natural catastrophe or the ongoing pandemic, when adverse economic impacts are being experienced by all residents and businesses, creating a Z-factor that would allow cost recovery of all costs incurred related to a natural catastrophe or declared emergency will not seem reasonable nor equitable to customers who do not have similar financial guarantees. The Z-factor should allow the Commission to consider the appropriate balance relating to cost recovery between shareholders and customers.

E. MRP CONTROL PERIOD TERMINATION PROCEDURES.

While the Commission has determined that the MRP should be extended beyond the current three-year (or triennial) rate case filing cycle, a review of D&O 36326 and Order No. 36388 did not reveal any further Commission findings defining what should actually transpire on or before the conclusion of the five-year control period.³⁶ Consistent with its Initial and First Updated Proposals, the Consumer Advocate continues to recommend there be no scheduled return to traditional, forecasted test year rate cases at the end of the Control Period. We reiterate that traditional utility rate cases have the effect of translating increased expenses and new rate base investments into higher utility rates, effectively rewarding higher costs with larger revenues and earnings and could be

³⁶ While it might be argued that the Commission's language ("... a five-year MRP represents a reasonable step towards transitioning to a longer control period between rate cases..." (emphasis added) from D&O 36326, at 28) implies that there should be an expectation that there will be a rate case every five years, the Consumer Advocate, as already suggested earlier, contends that it would be inappropriate to assume that "rate cases" in the future will be traditional COSR rate cases.

perceived as maintaining the direct link between capital investment and utility earnings -contrary to the incentive and cost control goals of PBR design. Furthermore, the Consumer Advocate contends that existing COSR may dissuade a utility company from implementing long-term measures to reduce costs since, any such long-term reductions in O&M expenses would be re-captured in a traditional rate case and would thus pass on any such long-term cost savings to customers without allowing the utility to retain any portion of those cost savings benefits. Instead, COSR encourages only short-term cost savings measures where the utility is able to retain short-term benefits for shareholders in intervals between rate cases and, by the time of the next rate case, any such short-term benefits can be explained away as only a temporary aberration.

As noted in the Consumer Advocate's Initial Proposal, resumption of traditional COSR upon expiration of an initial MRP term is inherently problematic for several reasons:

- Perverse incentives are created for utilities to “defer” cost incurrence during the MRP, particularly in the later years, anticipating an opportunity to seek increased rates enabling recovery of catch-up expenditures forecasted within a future rate case test year.
- Desired MRP cost-control incentives are diluted if resumption of COSR is scheduled to occur at a known future date.
- Gaming of PIMs is invited, where the timing of future rate cases would influence whether and when costs may be incurred to improve performance.
- Capital Expenditure bias is not mitigated if new capital investments made by the utilities during the MRP can be recovered through COSR after year five as rate base additions.

- Rate cases impose significant resource commitments upon the utilities, the Consumer Advocate, and the Commission; while traditional rate cases reduce affordability and distract from operational performance and important transformational activities. Any attempt to conduct COSR rate cases for all three utilities coincident with re-examination of other PBR terms would strain available resources and likely delay needed updates to the PBR framework.
- Act 5 requires that the Commission “break the direct link between allowed revenues and investment levels”³⁷ and it is questionable whether this requirement would be met if resumption of COSR is scheduled or anticipated at the end of the five year control period.

The resumption of formal rates cases for all three utilities simultaneously, based upon utility-developed forecast data, would needlessly impose an unprecedented resource burden upon the Consumer Advocate, the Commission, and other concerned parties, and would occur at the same time that all concerned stakeholders should instead focus available resources upon the review and improvement of PBR provisions.

Rather than resuming formal forecasted test year rate cases for each utility, the Consumer Advocate proposes that an expedited earnings assessment be conducted for each utility after year five, based upon historically reported and properly adjusted and normalized ESM calculations. This earnings review could be expedited only by avoiding reliance upon subjective and inherently controversial forecasted data and should be performed in parallel with an unstructured MRP Review. Upon installation of a symmetrical ESM, it is envisioned that the utilities will annually prepare and file a calculation of achieved earnings for each utility, that will be subject to regulatory review and approval each year. These filings will provide a continuous record and awareness of the financial performance of each utility. Additional filings will be required to administer

³⁷ 2018 Haw. Sess. Laws, Act 5.

performance incentives, decoupling and the ARA mechanisms. These filings will provide a continuum of data the Commission and Parties can rely upon to evaluate PBR results and any need for changes at control period end.

In the last year prior to the end of the initial five-year control period,³⁸ the Commission should require each utility to file its normally scheduled decoupling/ARA and performance incentive filings that would support a continuation of the MRP with appropriately calculated ARA and ESM values, along with a detailed discussion of each of the Companies' proposed revisions to the MRP terms and PIMs, based in part upon earnings reported in the preceding calendar year or years and upon experience gained in administration of PIMs. This filing could also be supportive of a one-time "update" to revenue requirements using an historical test year (e.g., calendar year 2024), with adjustments normalizing unusual or non-recurring transactions/events but otherwise employing established ratemaking methods from the ESM.³⁹ If warranted at that time, an updating of cost of capital inputs and re-calibration of the ESM mechanism could also be considered. Other changes to the PBR framework may be undertaken at that time to

³⁸ Assuming a Phase 2 decision and order is issued in December 2020 with an effective date in early 2021, it may be necessary to extend the start of the control period into mid-2021 or have it run a few months in excess of five years in order to employ historic calendar year data that is not almost a year old by the time data it is factored into the one-time "update."

³⁹ One topic that has been raised but not yet specifically addressed relates to the question of the Companies' legal rights to file general rate cases. The Companies stated in their Updated Comprehensive Proposal at page 7, "The Companies are updating their position so that a general rate case does not automatically occur at the end of the Control Period, provided that the Companies retain the right to file a full-scale general rate case, or to request that there be no rate case or a simplified rate case. At the same time, the Commission would retain the right to require a full-scale general rate case if the Companies request a simplified rate case, and to require a full-scale general rate case or a simplified rate case if the Companies request that there be no rate case." The Consumer Advocate observes that, if the Companies and the Commission retain the right to file a rate case at will, the specification of end-of-control-period PBR continuation procedures or off-ramps for financial reasons during the control period may not be necessary or enforceable.

address issues identified by the Commission, the utilities, or other parties within the five-year control period.

Following review and evaluation of the Companies' end-of-control-period filing, the Commission could approve the utilities' filed ARA (i.e., RAM's successor) adjustment in that year as an interim change in target revenues for each utility and then suspend the effective date of any proposed permanent rate changes or other proposed substantive regulatory framework amendments, in order to consider intervention requests and to develop a list of issues and procedural schedule needed to create a sufficient record supporting any granted rate relief or PBR modifications. Depending on the ordered procedural schedule, any resulting rate changes beyond ARA revenue relief could initially be implemented on an interim basis, followed by a final order once all evidence is considered. This approach would position the utilities, assuming that the utilities are the applicant, as the moving party with an initial burden of proof to justify each proposed modification to the MRP, ESM, performance incentives or any proposed one-time revenue adjustment, based upon historically measured revenue requirements for each utility and performance experience gained during the control period.

The Consumer Advocate's suggested PBR review approach would apply factual information collected through annual ESM and performance monitoring in the context of a scheduled, but only broadly defined, review window. This approach envisions the possibility of a variety of outcomes informed by actual utility performance, none of which requires resumption of traditional COSR rate cases:

1. Financial and operational performance after five years may support a conclusion that many of the MRP, performance incentives, and other

elements of PBR have functioned largely as intended, such that only minimal prospective changes are required for individual elements.

2. Persistently inadequate annual ROE may reveal under-recovery of actual utility costs and recurring ESM recoveries, such that a one-time adjustment in target revenues, based upon historical and properly normalized/adjusted earnings should be considered prospectively without the conduct of a traditional forecasted test year rate case. Alternatively, utility-friendly revisions to inflation indices or ESM terms may be determined to be needed and appropriate on a prospective basis, in order to continue the MRP without one-time rate adjustments to target revenues.
3. Persistently excessive ROEs and recurring ESM reductions may support a future incremental one-time consumer dividend, downward revisions to target revenues, and/or consumer friendly adjustments to inflation indices or ESM terms that would be applied prospectively within a continued MRP (without the need for a traditional rate case).
4. New technologies or market developments may support revisiting the adopted regulatory outcomes or even a significant re-invention of the regulatory framework to be applied prospectively.

Flexibility in the scope and approach to PBR review after the five-year control period is highly desirable. Given the complexity of the issues involved, it is unlikely that the Commission and the Parties to this investigation will be able to define, at this time, the absolute best processes for use in five years (and beyond) to reasonably reset revenues and adjust other specifications for future MRP and other changes to the regulatory

framework. It is impossible to accurately predict where changes to the PBR framework may be needed after five years, but it is likely that adjustments can be made at that time based upon available reported financial and operational data, without the resumption of COSR forecasted test year rate cases, which would signal a costly and inefficient movement of regulation in the wrong direction. The Consumer Advocate anticipates that the review that occurs at the end of the control period (and possible modifications) would be informed by regular reviews occurring prior to the end of the control period.

Annual filing and review procedures are proposed below, for regulatory oversight and administration of ARA, ESM and MPIR revenue adjustments throughout the control period.⁴⁰ Within each annual review, the Commission can evaluate the efficacy of the processes and the values that are being used for the various mechanisms. If, as mentioned earlier, there are observations about persistent same-direction reliance on the ESM to adjust earnings or recurring problems with other PBR elements, those observations could be acted upon in the end of control period review. Additionally, the five-year review should also include updating of the regulatory oversight processes to improve on the overall administrative efficiency of the PBR framework. It should be made clear that this end of period review is not an “off-ramp” but provides an opportunity to make any necessary “lane changes” to ensure that PBR is allowing the utilities to continue in the right direction towards clean energy adoption and carbon reduction, providing greater value to customers at affordable rates, improving overall utility performance, and streamlining regulation.

⁴⁰ The draft RBARA tariff in Exhibit 1, if approved by the Commission, would consolidate ARA and ESM regulation in a single tariff, while the draft MPSR tariff in Exhibit 5 would supplant the existing MPIR Guidelines if approved.

F. COST OF CAPITAL AND ACCOUNTING ISSUES.

The Consumer Advocate's Initial Proposal envisioned no need for revenue adjustments during the control period to account for changes to the allowed ROE or embedded cost of debt capital. These inputs to revenue requirement have remained relatively stable in recent years and the existing ESM calculation within the RAM tariff automatically updates the cost of debt capital, but not the authorized ROE. However, the risk of potentially large changes in capital market conditions impacting the utilities' cost of equity capital – whether favorable to the utility or customers - may merit some consideration. Several other PBR implementation accounting issues have also been raised in the Workshops and Subgroup meetings convened since Initial Proposals were submitted by the Parties. This section of the Consumer Advocate's Second Proposal Update is intended to outline the Consumer Advocate's current thoughts on those concerns.

In its Initial Proposal, the Hawaiian Electric Companies proposed a "Cost of Capital Adjustment Mechanism" ("COCAM") that would insert a Cost of Capital ("COC") factor into the target revenue adjustment mechanism or as a component of the Z-factor, employed to periodically reset a COC "base" in proceedings held either on a scheduled basis or when needed to respond to extraordinary changes with a substantial impact on the COC, along with a mechanism to compare authorized ROEs to a published benchmark interest rate level, with formulistic piecemeal changes to revenue requirements when this variance exceeds a trigger value.⁴¹

⁴¹ Hawaiian Electric Companies Initial Comprehensive Proposal at 34-36.

Several existing cost deferral and amortization mechanisms are administered through periodic rate cases and the cessation of rate cases would complicate the completion of intended full recovery or return of intended amounts under such mechanisms. These include costs being deferred and amortized for several software development projects, variations in pension costs that are subject to tracking between rates cases, regulatory liability accounting for benefits promised to flow to ratepayers from recently installed enterprise accounting systems and provisions for new cost deferrals in connection with anticipated Grid Modernization and Demand Response initiatives.⁴²

A related and broader issue is the possibility that cessation of cost of service regulation within a PBR framework could trigger a determination by the Companies' auditor that Generally Accepted Accounting Principles unique to regulated businesses pursuant to Accounting Standards Codification 980 ("ASC 980") may no longer be permitted if utility rates are no longer designed to recover the specific entity's costs of providing regulated services. If the criteria within ASC 980 are no longer satisfied, the Companies would be required to cease recording and write-off their accumulated regulatory asset and liability balances.

⁴² See HECO-1605 filed with the Company's direct testimony in Docket No. 2019-0085.

1. Cost of Capital Adjustment Mechanism.

The Consumer Advocate does not support piecemeal adjustments to future utility revenues to account for changes in the cost of capital. Adoption of a PBR regime should move away from linking utility rates to utility costs, rather than creating another layer of price/cost linkage as would occur under the Companies' COCAM proposal. If there are observed significant changes in the cost of capital under PBR regulation, this should not trigger an automatic separate proceeding to address this observed change; rather, utility management should adjust its resource allocation decisions to optimize cost-effectiveness, using either more or less capital investment (compared to purchased contract services) as appropriate, until a review (and modification) of the relevant ARA and performance mechanisms can occur. While management has little control over the cost of capital in the broader market, it can control how much capital is invested when costs change. From a ratemaking perspective, it would be improper to adopt single-issue ratemaking under a PBR framework for changes in the cost of capital when many other input costs may be changing that mitigate the impact of cost of capital impacts.

The Consumer Advocate and the Commission have generally not supported single-issue rate adjustments except in instances where uniquely large and volatile costs merit such treatment.⁴³ Even if it might be argued that the introduction of a cost of capital mechanism would not be single-issue ratemaking if it is adopted as part of the overall change in adopting an enhanced PBR framework, the inclusion of such a mechanism would seem to belie the efforts to break the link between earnings and capital investments. Finally, the inflation "I" factor should tend to change directionally with

⁴³ See fn 27.

interest rates, such that periods of significantly higher market interest rates in the future can be expected to coincide with larger inflation-driven ARA increases caused by the “I” factor. A combination of piecemeal cost of capital adjustments increased ARA inflation factors would tend to globally and perhaps excessively compensate the utilities for experienced capital cost increases.

The five-year review window at the end of the Control Period would provide an opportunity for consideration of any significant changes in the cost of capital that have occurred at that time. In the event the Commission is convinced that the risk of significant changes in the cost of capital within the Control Period merit some special treatment as part of its approved PBR regime, there is no need to commence potentially complex and controversial COS proceedings aimed at implementing piecemeal revenue changes. Instead, the ESM sharing grid around the authorized ROE could be adjusted upward or downward to account for changes in market interest rates and cost of equity; any such effort should occur with input from the Consumer Advocate and other interested parties. This approach would mitigate the single-issue ratemaking problems and the cost and complexity of COC proceedings, while ensuring that the ESM deadband and guardrails around financial outcomes are preserved in a manner that is responsive to changing capital market conditions. An example of how formulistic changes to the ROE midpoint of the ESM sharing grid might be revised or indexed to changes to market interest rates is set forth in Exhibit 3. The Consumer Advocate does not view this ESM complication to be warranted at this time but, if the Commission believes an explicit measure is required, this approach may have some appeal as a better alternative than COCAM.

2. Administration of Existing Deferral/Amortization Mechanisms.

A series of previously established and recently approved cost deferral and amortization mechanisms are administered through periodic rate cases.⁴⁴ Other deferral accounting entries recorded on the utilities' books are driven by ECRC, PPAC, MPIR, REIP and other surcharge recovery mechanisms that are expected to continue under PBR. For the first "rate case" administered category of regulatory accounting, the cessation of rate cases during and potentially beyond the Control Period will create new uncertainty regarding the required accounting and reporting for regulatory assets and liabilities and the periodic amortizations to be recorded as charges or credits to income. With no opportunity in rate cases to affirmatively address the commencement or completion of the amortization entries needed to accomplish full recovery or return of only the intended amounts, some guidelines are needed to produce meaningful financial reports that are relied upon by investors and provide the key inputs into annual ESM calculations.

Consistent with its First Updated Proposal, the Consumer Advocate continues to propose that aggregate amounts of regulatory asset and liability amortizations last approved in a completed rate case continue to be recorded by each utility during the PBR control period and beyond such that, upon completion of amortizations for any specific regulatory asset or liability, the portion of aggregate recoverable amortization previously assigned to that asset/liability be applied proportionately to other regulatory asset/liability

⁴⁴ See, for example, HECO-1605 in pending Docket No. 2019-0085, where Hawaiian Electric's HR Suite, Budget System, CIS, IVR, DRMS, ERP and Phase 1 Grid Mod estimated deferred system development costs are included in the Company's proposed rate base and test year 2020 amortization expense. HECO-1602 summarizes the pension regulatory asset calculations amounts associated with the pension tracking mechanism for the 2020 test year.

balances until the net balance of all regulatory asset/liability balances is exhausted. The presumption under this approach is that embedded recovery levels in base rates, when expanded through ARA for inflation, will provide sufficient aggregate revenues to eventually accomplish reasonable recoveries and amortizations of such deferred amounts. These provisions would not apply to regulatory asset/liability accounts maintained for continuing cost recovery surcharge recoveries such as the ECRC, the PPAC and the RBA, where revenue recoveries continue to track actual recoverable costs.

3. Regulatory Accounting Under Asc 980.

In the event adoption of PBR causes regulatory accounting, as described in the immediately preceding section, to no longer be available to the Companies in their GAAP financial statements, the Consumer Advocate recommends the Commission direct the Companies to maintain a separate “regulatory” set of books for reporting to regulators and for administration of ESM and other PBR mechanisms. Desirable regulatory policies or outcomes should not be subordinate to financial accounting pronouncements. Financial accounting and reporting are not designed to establish the pricing of products and services and regulators should employ the financial inputs determined to be most relevant to their established policies in setting rates. As a point of reference, when local exchange telephone companies were subjected to increased competition and price-cap forms of regulation were employed at the federal and state levels, the companies were no longer able to maintain GAAP financial reporting on the same basis as regulatory reporting and routinely maintained a “set” of books prescribed by federal and state regulators.

If the Hawaiian Electric Companies were required to cease regulatory accounting and were directed to write-off their recorded regulatory assets and liabilities, the net result of any write-off may be quite favorable to reported earnings in the period recorded. A review of recorded balances as of June of 2019 reveals that regulatory liabilities owed to ratepayers at that time exceeded recorded regulatory asset amounts owed to the utilities by ratepayers.⁴⁵ Notably, any write-off required for GAAP financial reporting would have no impact upon regulatory reporting that could and should continue on a basis consistent with the Commission's policies.

G. MRP INCEPTION RATES.

The Consumer Advocate noted in its Initial and First Updated Proposals that the Commission has determined that it “will utilize the existing or pending ‘rate cases,’ respectively, in setting their target revenues for the initial MRP.”⁴⁶ We also noted that Hawaii Electric Light has a pending final decision and order in a 2019 test year general rate case in Docket No. 2018-0368 in which new interim rates were approved in November 2019.⁴⁷ Hawaiian Electric Company also has a pending general rate case, based upon a 2020 test year that would support inception rates. Acknowledging that the PBR framework remains under consideration with several procedural steps remaining in 2020, it appears obvious at this time that all but Maui Electric will have completed a

⁴⁵ Hawaiian Electric's response to CA-IR-9, Attachment 2 shows regulatory liability balances across the three utilities totaling \$953 million, while regulatory assets totaled \$787 million at the same date.

⁴⁶ D&O 36326 at 28-29.

⁴⁷ Interim D&O dated November 13, 2019 in Docket No. 2018-0368.

relatively “fresh” general rate case proceeding at the commencement of PBR regulation.⁴⁸ In Order No. 37119, recently filed in Docket No. 2008-0274, the Commission terminated the triennial rate case filing requirement for Maui Electric under the existing decoupling regime.

With nearly or recently completed rate cases for both Hawaiian Electric and Hawaii Electric Light, the Commission should consider simply using existing Maui Electric 2018 test year rate case results, increased by the cumulative RAM target revenue increases approved in subsequent years. Adoption of target revenue levels that are currently in place within a new MRP would reflect the conclusion that recent Commission approved rates continue to be reasonable, especially given the incremental revenue adjustments provided the utilities through the RAM and various other existing tracking and cost recovery mechanisms. The adoption of existing target revenues and rates would help to eliminate the incentive for the utility companies to aggressively seek inflated revenue requirements and target revenues at the inception of the MRP and would free-up resources otherwise required to process a new MECO rate case for work on early administration of any approved PBR as well as other pending dockets. Furthermore, avoidance of unnecessary future rate cases would allow limited resources of the Commission Staff, the Consumer Advocate, and the utilities to be redirected to business transformation activities and other pending proceedings, as well as toward more progressive regulation through newly created PBR mechanisms approved in this docket.

⁴⁸ The “next” Maui Electric rate case, if filed, would have a 2021 test year under the RBA/RAM triennial rate case filing requirement. It should be noted, however, that Decision and Order No. 36129, filed in Docket No. 2017-0150, Maui Electric’s most recently completed rate case, was filed on March 18, 2019. Thus, the Consumer Advocate contends that it should be assumed that Maui Electric’s current rates are “stale.”

Continuation of existing rate levels at MRP inception is the most feasible way to install the needed PBR framework in an administratively practical, efficient, and timely manner consistent with the Legislatures' direction (through Act 5) to break the direct link between capital expenditures and utility revenues. The Consumer Advocate's recommendation also would represent strong support for the intent of Act 5. The completion of yet another annual COS rate case for Maui Electric Company would complicate this objective and achievement of the priority outcomes identified in this docket and perpetuate the affordability problems and perverse incentives that are attributable to COSR.

The Consumer Advocate supports the D&O 36326 finding that the most practical and timely approach to MRP inception rates and revenues is the adoption of currently effective revenues/rates for this purpose. Inception rates are only one of the many inputs driving the future revenues and earnings of the utilities and they should be presumed reasonable unless and until proven to be unreasonable. The utilities' future financial performance under an MRP will be increasingly driven by the inputs used to provide for inflation, productivity and consumer dividends, and efficiencies gained along with new performance incentives and potential new platform and other revenues. Furthermore, a prudently designed ESM and relevant ESM parameters will automatically correct, if necessary, for any significantly "incorrect" revenue starting points. It is more important to carefully evaluate whether the framework adequately responds to likely performance and financial variances on a going forward basis, rather than exhaustively resetting the initial rates.

H. EARNINGS SHARING MECHANISM (“ESM”).

1. Introduction.

The Consumer Advocate observed in its Initial and First Updated Proposals that D&O 36326 provides for implementation of a revised ESM that provides both “upside” and “downside” sharing of earnings that fall outside of a Commission-approved range, though not necessarily “symmetrical” (i.e., mirror image) amounts. The Commission noted that a well-designed ESM will maintain the utility’s financial integrity and reduces risk to the HECO Companies’ bondholders and shareholders, which will have a corresponding reduction in the cost of capital, benefiting all customers.⁴⁹ No revisions to our initially recommended ESM provisions were proposed within the Consumer Advocate’s First Updated Proposal submitted in January. The Consumer Advocate has again reviewed its initially proposed ESM and again proposes no revisions to it at this time.

2. Discussion.

The Consumer Advocate’s proposed ESM contains the following essential characteristics:

- Inclusive calculation of achieved earnings for sharing, including all utility revenues and costs from ongoing operations, the costs of achieving and benefits of attaining performance incentives, the costs to develop and

⁴⁹ D&O 36326 at 32-33.

revenues earned from innovative new product and services, all adjusted to a regulatory basis of accounting.⁵⁰

- A Return on Equity (“ROE”) measurement of earnings that fully captures the bottom line income of the utility, compared to the amounts of actual invested capital in the business, so as to “scale” the amount of earnings in proportion to the cash flow needs of the business in meeting credit metrics and investor expectations.
- A Broad ROE Deadband, so as to not dilute the financial incentives to stimulate cost savings by management and not dilute the performance incentives installed as part of PBR.
- Gradually increasing ratepayer sharing as earnings deviate further outside of the ROE Deadband, in order to ensure maintenance of adequate credit metrics and access to capital when earnings decline significantly, while returning larger shares of excessively high achieved ROE that may result from mis-specification of MRP inputs, PIMs/SSMs or other regulatory failures.

⁵⁰ At present, the risk sharing provisions within the ECRC mechanism are excluded in calculating annual earnings for ESM purposes. The Consumer Advocate recommends changing this policy, so that any costs incurred to improve fuel procurement and generation management processes are “matched” to the achieved incentive values and to be sure that risk sharing results are not ignored when using ESM to ensure financial integrity metrics are satisfied.

- Consistently reported annual ESM results that can be used for continuous review of utility financial performance, so as to monitor achievement of targeted PBR outcomes while providing cumulative data to inform the scheduled review of the MRP at control period-end.⁵¹

As a fundamental principle, earnings measurement within the ESM should be calculated on an inclusive basis, that captures all existing and new revenues as well as all utility expenses and rate base-related costs. Absent a Commission order approving non-jurisdictional (i.e., below-the-line) treatment of the revenues or costs associated with a given utility activity, the financial impacts of all utility undertakings should be included in the ESM. For example, if higher costs are incurred by the utilities to expand into new markets for electric vehicle charging or to provide other new products or services, it is then essential to also include all of the associated new revenues, particularly given the difficulties associated with accurately isolating and excluding all direct and indirect costs arising from such new ventures.

Similarly, it is important to also include all PIM/SSM related rewards, penalties and the related costs incurred by the utilities to achieve performance, so that ESM goals are not undermined by selectively excluding incentives, penalties, or new platform revenues so that the “cost” incurred by the utilities at the achieved level of performance is reasonably matched to the corresponding PIM/SSM revenue impacts. An inclusive approach is also needed for any fuel cost sharing incentives arising from the ECRC mechanism, because any labor or consulting costs incurred by utilities to more efficiently

⁵¹ As a starting point, the utilities’ Spring annual decoupling transmittals contain calculated achieved ROE results for the prior calendar year on Schedule H.

manage fuel expense should be matched with the incentives earned or paid by customers for those efforts.

Without periodically recurring rate cases, the utilities will have an expanded opportunity to earn and retain efficiency savings, targeted Performance Incentives, along with potential new service revenues that may eventually materialize, that should all be backstopped by a carefully designed earnings monitoring and sharing regime. The Consumer Advocate's recommended "inclusive" approach to ESM would also maintain the needed linkage between Generally Accepted Accounting Principles ("GAAP") reported financial results and ESM regulation calculations, recognizing that the utilities are obligated to include all revenues and costs in reporting income to the financial community.⁵² Including all PIM and fuel recovery incentives and related costs to achieve such incentives avoids complicated and potentially contentious revenue/cost classification and exclusion disputes around ESM filings. Only an "inclusive" ESM calculation of sharable earnings can fully serve the purpose of providing common-sense "guardrails" to protect utility financial integrity while also preventing excessive utility earnings, which is a stated goal in Decision and Order No. 36326.⁵³

A broad ROE deadband for the ESM should be specified by the Commission, to avoid excessive dilution of intended financial and operational incentives under PBR, while insuring acceptable financial performance within a broadened symmetrical range around the estimated cost of equity capital. Installing a large ROE deadband without sharing

⁵² The ESM accounting proposed by the Consumer Advocate would retain procedures in use currently in annual decoupling filings, where GAAP financial results are adjusted to a ratemaking basis of accounting that excludes incurred expenses not recoverable from customers and adopts other regulatory accounting conventions.

⁵³ D&O 36326 at 5-6.

within this range ensures that earnings sharing does not dilute the intended cost control incentives from the MRP or deny shareholders the impacts of PIM/SSM incentives and penalties earned while earnings stay within that range. On the other hand, when monitored earnings deviate materially outside of an acceptable deadband, application of earnings sharing would appropriately moderate the cumulative effect of both PIMs and cost control incentives, so as to ensure acceptable overall financial results that maintain the utilities' financial integrity and do not produce windfall profits at ratepayers' expense.

Finally, annual ESM results, along with cumulative utility performance against PIM/SSM metrics and baselines, along with additional relevant data produced within the many ongoing planning dockets should inform the Commission within any future review of PBR, after five years of experience have been accumulated. There is no need to revert to traditional rate case filings and COSR at the end of the Control Period. ESM results will provide an important tabulation of PBR financial results that can be relied upon to help evaluate and modify PBR elements as needed. The beneficial “guardrail” attributes of a properly designed ESM should eliminate the need for any return to traditional COSR at the end of the Control Period or for any “off-ramp” provisions that are discussed in the next section of this Second Proposal Update, enabling a regulatory focus upon any needed revisions to the PBR framework, rather than defaulting back to complex and costly forecasted test year rate cases for all three utilities.

An illustrative form of ESM was presented in the Consumer Advocate's Initial and First Updated Proposals, which has been discussed in Workshops and Subgroup Meetings since that time and, based on those discussions and the absence of significant raised concerns, appears to be generally confirmed as reasonable. In this Second

Proposal Update, the Consumer Advocate continues to recommend the same ESM matrix with the following characteristics:

Basis of Measurement: Return on Average Equity (Schedule H)⁵⁴

Midpoint of Deadband: Most Recent Commission-approved ROE

Width of Deadband (no sharing): Plus / Minus 200 basis points

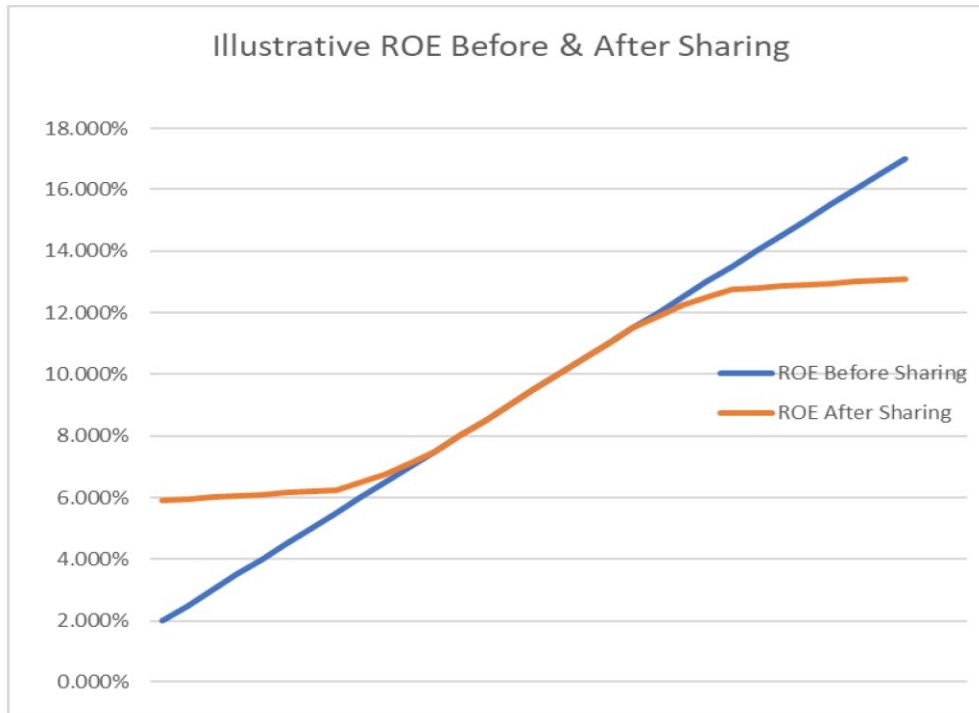
First 100 Basis Points of ROE: 25% to/from customers

Next 100 Basis Points of ROE: 50% to/from customers

All ROE Beyond 400 Basis Points: 90% to/from customers

Assuming for discussion purposes the currently authorized ROE of 9.5 percent, sharing would occur only when actual ROE levels deviate materially from the proposed wide range of “acceptable” deadband levels. More specifically, there would be no earnings sharing when reported ROE (before ESM impacts) ranges from 7.5 percent to 11.5 percent. Outside of this deadband, customers would then be charged or credited with the revenue value of 25% of the “next” 100 basis points below or above this range (ROE of 6.5% to 7.5% or 11.5% to 12.5%), 50% of the “next” 100 basis points (ROE of 5.5% to 6.5% or 12.5% to 13.5%) and 90% of all remaining variances (below 4.5% or above 13.5%). The following chart illustrates how utility reported ROE levels, before and after ESM effects, would be impacted by this ESM proposal:

⁵⁴ Specific procedures for calculating earnings, rate base, updated cost of debt and ROE have been developed and used in decoupling transmittals approved by the Commission in all recent years.



Because of the large 90 percent sharing at the tail of each ROE extreme, even severe fluctuations in pre-sharing ROE are remedied through ESM sharing, making it nearly impossible for the utilities to earn much below 6 percent or much above 13 percent ROE levels after sharing.⁵⁵ Ratepayers remain “on the hook” for the vast majority of the earnings variability experienced outside the deadband under this proposal, so as to safeguard utility access to capital at reasonable terms at the left side of this graphic while avoiding excessive compensation to shareholders on the right side.

The efficacy of the Consumer Advocate’s ESM mechanism has been confirmed through financial sensitivity calculations that iterate various assumed rates of cost increases for each utility, modeled in the context of the I and X values for ARA assumed herein, on target performance regarding PIM incentives and with limited assumed

⁵⁵ For example, with zero net income for equity investors, the recommended ESM would increase accrued revenues to cause the utilities to earn and report a 5.7 percent ROE.

recoveries of qualifying costs through the MPIR. These results were summarized in the Consumer Advocate's First Updated Proposal filed in January and the Exhibit 4 filed then containing model output and will not be repeated here.⁵⁶

As an independent stress test of ESM effectiveness in protecting utility financial integrity in this Second Updated Proposal, the Consumer Advocate has examined the impact upon utility credit metrics of assumed dramatic declines in reported utility earnings that would be mitigated by the recommended ESM. We have calculated the estimated Standard & Poors Core Ratios of Funds From Operations divided by Debt ("FFO/Debt") and Debt divided by Earnings Before Interest, Taxes, Depreciation and Amortization ("Debt/EBITDA") for each utility based upon financial results presented for calendar 2019 in the Companies' decoupling transmittals based upon actual earnings, and then simulated what would happen if net income (before sharing) was instead reduced to zero for each utility. At a reported ROE of zero, the Consumer Advocate's proposed ESM would charge ratepayers to collect sufficient ESM revenues to collect an extra 0.25% of ROE in the first sharing band, another 0.5% ROE in the second sharing band and then another 4.95% ROE in the final sharing band, producing an "after-ESM" achieved ROE of 5.7%. The following table illustrates the very modest unfavorable impact upon FFO/Debt and Debt/EBITDA ratios of zero net income, relative to actual earnings results reported by the utilities to the Commission for 2019:

⁵⁶ Due to the lack of comments and updated data to recast the model, the Consumer Advocate has not provided an updated Exhibit 4 with this second update but anticipates providing an update with its statement of position next month assuming that relevant updated data and/or comments are provided.

<i>Credit Metrics at 2019 Reported Versus Assumed Zero ROE - with ESM:</i>			
	HECO	HELCO	MECO
Reported 2019 ROE (Reg. Acctg.)	8.82%	6.72%	7.96%
FFO / Debt (S&P Method)	17%	18%	18%
Debt / EBITDA (S&P Method)	3.95	3.65	3.92
ESM Adjusted ROE w/No Earnings	5.70%	5.70%	5.70%
FFO / Debt (S&P Method)	16%	18%	17%
Debt / EBITDA (S&P Method)	4.02	3.66	3.97

The utilities' credit metric ratios results fall within the broad ranges published by Standard & Poors at reported levels of earnings in 2019 and stay within these ranges even if utility income drops to zero, due to the substantial protective boundaries created by 90 percent ratepayer absorption of otherwise inadequate or excessive earnings.⁵⁷

The Consumer Advocate would implement its ESM proposal by either charging or returning the ratepayers' share of earnings pursuant to annual ESM calculations as an adjustment to Target Revenues within the Consumer Advocate's proposed RBARA tariff (see Exhibit 1). When each utility's books are closed at year end, the Company should record as revenues an annual charge or credit to the RBA balance that can be recognized in December as part of earnings to moderate the range of reported ROE levels. The actual recovery or return of such accrued revenue amounts would then occur through routine annual RBA rate changes, along with ARA and other adjustments, after review and approval by the Commission.

⁵⁷ According to HECO-2608 in Docket No. 2019-0085, Hawaiian Electric's 2020 test year rate case, the range of ratios expected for FFO/Debt at HECO's current S&P rating are 23 to 13 and the Debt/EBITDA ratio range is 3.5 to 4.5.

I. DEVELOPMENT OF OFF-RAMP PROVISIONS.

As noted in the Consumer Advocate's Initial and First Updated Proposals, D&O 36326 states that consideration should be given in Phase 2 to "examining 'off-ramp' mechanisms to provide for review of approved PBR mechanisms, pursuant to specified circumstances."⁵⁸ The Consumer Advocate continues to recommend that there is no need to include off-ramp provisions within the Commission's approved PBR framework, given the controlled and intentional risks and opportunities being designed into MRP inputs and performance incentives, along with the substantial risk mitigation afforded by the recommended symmetrical and inclusive ESM set forth above. The Consumer Advocate remains very concerned that any off-ramp provisions⁵⁹ could serve to prematurely modify or abandon some or all of the MRP and performance incentives resulting from Phase 2, which would dilute the cost control and performance incentives that PBR is intended to create. In place of off-ramps, the Consumer Advocate prefers to rely upon the symmetrical ESM described in the preceding section of this Second Proposal Update to backstop financial performance and provide needed support for the utilities' financial integrity as well as a carefully implemented annual review process coupled with the review at the end of the control period.⁶⁰

As more fully addressed in Section IV. G., the Consumer Advocate recommends a comprehensive annual review process for the performance mechanisms. The

⁵⁸ D&O 36236 at 33.

⁵⁹ Throughout the discussions in the workshops and subgroups around "off-ramps", it became clear that different parties had different definitions of what an off-ramp might be. It is the Consumer Advocate's impression that, eventually, "off-ramp" was meant to mean terminating PBR and returning to COSR. Throughout the rest of this discussion, the use of "off-ramp" should be understood to mean a return to COSR.

recommended review procedures for performance, if followed, additionally avoid the need for off-ramp provisions.

J. REVISIONS TO THE MPIR ADJUSTMENT MECHANISM.

1. Introduction.

The Hawaiian Electric Companies have employed the Major Project Interim Recovery (“MPIR”) adjustment mechanism for recovery of significant new capital expenditure and related operating expense costs for the Schofield Generation Station, the West Loch Photovoltaic generation and Phase 1 of the Companies Grid Modernization Strategy.⁶¹ A large portion of the Companies’ recent capital spending on Major Projects has been separately recovered, above the RAM Cap, through the MPIR mechanism. D&O 36326 directs that “[t]he MPIR adjustment mechanism will continue to provide revenues for extraordinary projects as approved by the commission, above revenues established by the ARA.”⁶²

The existing MPIR mechanism provides incremental revenues above the RAM revenue cap limitation for Major Projects, subject to submission of a business case

⁶⁰ The annual filings needed to administer the ESM and other continuing mechanisms would serve to regulatory provide financial information to the Commission and the Consumer Advocate providing insight into any PBR elements producing extreme or unusual outcomes that require more urgent attention and/or modification.

⁶¹ The Commission authorized recovery of capital investment and O&M expenses for the Schofield Project in Decision and Order No. 35556 (at 74) and Order No. 35953 (at 12) both in Docket No. 2017-0213. In Decision and Order No. 36230 (at 58; as clarified by Order No. 36334) in Docket No. 2018 0141, the Commission approved the Hawaiian Electric Companies’ proposed MPIR recovery methods for the Grid Mod Phase 1 project. In Order No. 36335 (at 2) in Docket No. 2016-0342, the Commission affirmed that it intends to approve interim recovery of project costs for the West Loch PV project through the MPIR adjustment mechanism.

⁶² D&O 36326 at 33.

proving eligibility and justifying the Project, Commission advance approval and any relevant conditions imposed by the Commission. D&O 36326 also clarified that this docket “presents an opportunity to address capital bias that may be perpetuated through the current MPIR adjustment mechanism and explore how the MPIR may be used to address incentives regarding capital expenditures and operational expenditures. Accordingly, the Commission clarifies that during Phase 2, the parties should consider relief provided under the MPIR adjustment as distinct from potential relief under the ‘Z-Factor’ component of the MRP indexed revenue formula.”⁶³ The MPIR mechanism represents the primary opportunity for the utilities to seek recovery in the future of specific Major Project-related costs, thereby increasing revenues above ARA allowed annual revenue increases. Therefore, it is essential to carefully define and limit the types of activities and costs recoverable through MPIR to only projects and programs that are unique and transformative in nature and are not associated with routine, business as usual functions. In this Second Proposal Update, the Consumer Advocate has drafted a proposed Major Project Special Recovery (“MPSR”) Provision tariff in order to document and clarify, within a tariff, the existing terms and conditions within the Commission’s MPIR Guidelines, with certain modifications described herein.⁶⁴

⁶³ *Id.* at 34-35.

⁶⁴ As will be discussed further, the Consumer Advocate is proposing to replace the MPIR with the MPSR since the term “interim recovery” referred to cost recovery in the interim period between rate cases and the Consumer Advocate seeks to make clear the break from that origin.

2. Discussion.

The Commission's approved MPIR Guidelines contain detailed definitions and criteria for "Eligible Projects" in six areas. In reaction to discussions of MPIR applicability to various types of projects and costs, the Consumer Advocate proposes to replace the existing Guidelines with a new Major Project Special Recovery ("MPSR") Provision tariff included in Exhibit 5, that states the purpose of special recovery and increased revenues above and beyond the RBARA tariff, while reiterating most of the definitions, eligibility and filing requirements from the MPIR Guidelines, and then adding newly proposed "Evaluative Criteria" to the tariff. Approved MPSR increases to target revenues would also be summarized within the tariff for each utility and be carried into the revenue reconciliation procedures within the RBARA tariff.

The Consumer Advocate proposes no expansion in the scope of Major Project eligibility that are stated in the existing MPIR Guidelines for MPIR/MPSR recovery within the MPSR tariff. However, several changes to the definitions within the proposed MPSR tariff have been made to eliminate any appearance that the capital bias may be perpetuated by specifically noting that both capital expenditures as well as related Major Project operating and maintenance expenses, both net of any expense savings or other related benefits, are eligible for recovery through MPSR procedures. This would clarify language in the existing definitions within MPIR Guidelines that reference, "'Costs' means, inclusively, costs associated with return on and recovery of capital investment and/or expenses." In instances where transformative Major Projects that qualify for special cost recovery are cost-effectively provisioned using contracted services or other

expensed costs, rather than capitalized costs, it should be clear that MPIR/MPSR does not favor utility capital expenditures or perpetuate capital bias.

The proposed MPSR tariff repeats existing MPIR language within the “Eligible Project Applications” to note that recoverable costs must be, “...transformative in nature and are not routine replacements of existing equipment or systems with like kind assets, relocations of existing facilities, restorations of existing facilities, or other kinds of business-as-usual investments.”⁶⁵ Clarifying language is also inserted into the MPSR stating, “If a Major Project includes costs for both transformative activities associated with the Eligible Project, as described above, as well as characteristics of routine replacement, relocation or other business-as-usual work, only that portion of the Major Project costs reasonably attributed or allocated to transformative work shall receive MPSR cost recovery.”⁶⁶ This clarification has the effect of excluding any portion of qualifying Major Project costs that should be considered routine replacements of existing plant assets or expenses that would have been incurred but for the Major Project, such as employee labor costs charged to the Major Project that are routinely recovered within the utility’s target revenues.

The Consumer Advocate does not support liberalization of the existing MPIR qualification criteria as proposed by the Hawaiian Electric Companies in their Initial Proposal.⁶⁷ Expansion of special revenue recovery may invite unlimited new filings

⁶⁵ Exhibit 5, page 3.

⁶⁶ *Id.*, page 4.

⁶⁷ Initial Comprehensive Proposal of the Hawaiian Electric Companies at 27, Exhibit C.

seeking MPIR recovery for vaguely defined new categories of non-transformative utility spending

Building upon the experience with and Commission direction on the MPIR process, the Consumer Advocate's proposed MPSR tariff in Exhibit 5 could serve to replace the Commission's MPIR Guidelines, adopting the principles within the existing Guidelines with modest changes to clarify the eligibility criteria and address more substantive proposed detailed evaluative criteria. These eligibility and evaluation terms are intended for use by the utilities in preparing future MPSR filings, defining eligible projects, describing the supportive documentation needed to provide the cost/benefit justification including operational performance commitments and revenue requirement calculations required to solicit Commission approval.

K. CONTINUATION OF THE RBA AND OTHER PASS-THROUGH MECHANISMS.

As noted in its Initial and First Updated Proposal, the Consumer Advocate continues to support decoupling and the recovery of fuel and purchased power expenses through the Revenue Balancing Account ("RBA") and the ECRC/PPAC, respectively. D&O 36326 would continue revenue decoupling through the existing RBA, while RBA would continue to serve as the mechanism for implementing revenue adjustments resulting from the ARA, performance incentives, and MPIR revenue adjustments specifically approved by the Commission.⁶⁸ This proposal is consistent with the Consumer Advocate's recommendations within the new RBARA tariff (Exhibit 1) so as to

⁶⁸ D&O 36326 at 35-36.

provide revenue stability that is supportive of utility credit metrics that serve to support capital formation and financial integrity at the utility level, while virtually eliminating any throughput bias favoring increased energy sales that would be inconsistent with the State's energy efficiency goals, demand response initiatives, and the desired continuing growth of customer-owned distributed energy resources.⁶⁹

The Consumer Advocate continues to recommend that ECRC continuation be conditioned upon the conduct of periodic financial and management prudence audits of the includable expenses and reconciled revenue recoveries and that ECRC risk sharing gains and losses expected to be experienced prospectively under the 98 percent energy cost variance approach (if retained) be fully included in ESM sharing calculations, as more fully explained herein. Risk sharing approaches should be carefully monitored to ensure the gains and losses retained by utility shareholders are driven by management performance and not uncontrollable movements in the market prices of petroleum products. The recommended audits of ECRC-recoverable costs should be tailored to address this concern and seek to both evaluate management performance and maximize the benefits to customers of any risk sharing incentives that are allowed to continue.

L. INNOVATION PILOTS AND NEW REVENUES.

The Parties were advised to consider and address how innovation and pilot programs can be encouraged within a PBR framework. The Consumer Advocate asserts that its recommendations for an MRP with a broad deadband is supportive of utility innovation and the development of new product and service revenues, in all instances

⁶⁹ Metrics Brief at 30.

where explicit subsidization of such development efforts by the general body of ratepayers is not desired as a matter of public policy. When utility management identifies any new business development opportunity, it is free to investigate and pursue each opportunity, incurring startup costs and then realizing any profits within reported earnings that are subject only to ESM and would otherwise be retained for the benefit of shareholders. No limitations upon pilot projects or other initiatives is imposed by MRP regulation and the absence of rate cases reduces the exposure of ratepayers to subsidization of the startup costs and risks of such initiatives. The Commission might also consider developing and allowing an appropriate SSM as part of the overall portfolio of SSMs to encourage innovative pilots or programs in order to encourage the development of pilots or programs that strive to deliver net benefits to consumers.

On the other hand, if explicit subsidization of specific new products or programs is desired, as a matter of public policy, the Commission is encouraged to develop performance targets and deploy incentives to achieve desired outcomes. This should occur independently and outside of MRP calculations under the proposed RBARA and MPSR tariffs. However, it is recommended that all of the costs and new revenues from such explicitly subsidized initiatives be included within the ESM calculations, in order for that mechanism to provide the financial integrity benefits for which it is designed. This would facilitate a careful review of pilots to determine whether the potential shift of risks, where explicit subsidization is sought, to consumers is reasonable as compared to the anticipated benefits from any pilot or program.

M. FINANCIAL MODEL PROJECTIONS.

The Consumer Advocate has participated in and contributed to the series of Workshops, Subgroups and informal meetings where financial modeling of PBR scenarios and potential outcomes have been discussed. Informal information requests have been submitted by the Consumer Advocate to the Hawaiian Electric Companies seeking the Companies' internal financial modeling efforts as well as the Companies' latest and most detailed financial projections for O&M expenses and capital expenditure estimates in granular detail sufficient to estimate what capital projects would be eligible for MPIR revenue increases.⁷⁰ Thus far, after submitting short-term forecasting models for all three utilities and seeking feedback from the parties or recommendations for improvement of model logic, the Consumer Advocate has received no feedback or recommendations. To date, the majority of the modeling efforts undertaken by the Parties have focused solely on the Oahu system and were limited to long-term forecasts. The Consumer Advocate has stressed the need to have a model that evaluates the potential impact on customers of each of the three systems and that focuses on the likely impact within the five-year control period. Without any feedback, the Consumer Advocate can only assume that there are no significant concerns with its short-term models. The Consumer Advocate recently received high-level results of Hawaiian Electric financial forecasts for multiple scenarios, but not the underlying detailed reports that would allow comparisons to Consumer Advocate financial model inputs and logic and with no updated information for HELCO or MECO. Additionally, new uncertainties impacting near-term

⁷⁰ Informal Requests CA-HECO-1, 4, 5.

financial forecasts have arisen from COVID-19 issues impacting the utilities and their customers that are being evaluated for consideration within updated forecasts.

For these reasons and because the MRP inputs recommended herein by the Consumer Advocate remain unchanged, we have not finalized comprehensive updates to the preliminary financial projections that were submitted with its January 15th First Updated Proposal, within Exhibit 4 of that filing. Instead, the Consumer Advocate's financial modeling will be updated for inclusion within its filed Statement of Position. We hope to be able at that time to include revised and more specific estimates of capital expenditures for each utility, isolating forecasted capital expenditure amounts qualifying for MPSR recovery, along with rate case outcome information from Docket Nos. 2018-0368 and 2019-0085, respectively.

N. RATE DESIGN CHANGES.

Periodic rate cases have been used traditionally as a venue to review and adjust the design of base rates for the utilities. Suspension of rate cases will remove this venue for consideration of routine rate design changes. Thus, the only opportunity to modify rate design may be limited to the more substantive rate structure revisions that may occur in other dockets where the Commission intends to evaluate advanced rate design approaches.⁷¹ Additionally, the Revenue Balancing Account ("RBA") charge is relied

⁷¹ For example, in Decision & Order No. 36230 dated March 25, 2019 in Phase 1 of the Grid Modernization Docket No. 2018-0141, the utilities were ordered to submit an Advanced Rate Design Strategy for consideration in Docket No. 2014-0192. The Commission has since determined that instead of addressing market track issues in Docket No. 2014-0192, it would be better to close Docket No. 2014-0192 and to examine market track issues, such as advanced rate design, in a holistic manner in a new proceeding. As a result, it is anticipated that these types of rate design and market track issues will be addressed in Docket No. 2019-0323.

upon between rate cases to reconcile and recover decoupling revenue variances and for the cumulative recovery of growing amounts of annual RAM and MPIR authorized revenues. Historically, these RBA, RAM, and MPIR cost recoveries are systematically “rolled into” base rates in triennial rate cases. Without periodic rate cases to accomplish the roll-in, RBA rate recovery of these cumulative adjustments could grow quite large and become inconsistent with reasonable rate design policies.⁷² In response to concerns about needed rate design changes and growing RBA recoveries, the Companies’ Initial Proposal suggested “...separate proceedings for redesigning base rates on a revenue neutral basis (i.e., take rate design out of the rate case).”⁷³ In its January update, this recommendation was reiterated, with the statement “[t]he Companies propose that the Commission, by order on its own motion, or upon petition by the Company for good cause shown, initiate a revenue neutral proceeding during the Control Period to reallocate revenues among customer classes, and/or redesign the rates within customer classes.”⁷⁴

The Consumer Advocate agrees that revenue neutral rate design changes will likely be needed in the absence of rate cases and recommends that the March 1 annual filings described below be employed to receive administratively simple filings and provide regulatory oversight on an annual basis for such changes. In the event major rate design changes are separately investigated and approved by the Commission in other dockets,

⁷² In pending Docket Nos. 2018-0368 and 2019-0085, the Consumer Advocate and Hawaii Electric Light Company / Hawaiian Electric Company agreed to modify the RBA rate from a per-kWh charge to a percentage of base revenue surcharge approach, but this change has not been addressed in any final rate order.

⁷³ Initial Comprehensive Proposal of the Hawaiian Electric Companies, Exhibit F, page 3.

⁷⁴ Updated Comprehensive Proposal of the Hawaiian Electric Companies, page 60.

it may be necessary to receive and review additional filings out of cycle to timely implement rate changes. Additionally, the default accounting should be that any new rate elements impacting electric sales revenues be fully recorded within accounts that are subject to decoupling reconciliation, so that any unexpected revenue impacts are automatically trued up through RBA accounting procedures.

O. FILINGS AND ADMINISTRATIVE PROCESSES.

The Consumer Advocate has developed a broad framework of recommended periodic filings, review intervals and rate change effective dates that could be employed if the ARA, ESM, MPIR/MPSR and performance incentive proposals described herein are approved by the Commission. These proposals contemplate a shifting of regulatory emphasis away from triennial forecast test year rate cases, redirecting such resources toward:

- Regulatory oversight of ARA and RBA calculations each year,
- Review of MPIR/MPSR and REIP filings when submitted,
- Analysis of reported earnings that impact the ESM each year,
- Annual reporting and review of Reported Metrics, Scorecards and performance incentives, and
- More intensive analysis of ECRC and PPAC filings and underlying costs.

In connection with the Consumer Advocate's Consumer Dividend recommendation set forth above, accelerating the effective date of the simplified ARA could be accomplished by submission of an abbreviated ARA filing on December 1 of each year, that provides sufficient documentation to support consensus projections of GDPPI and application of

this percentage increase to target revenues on an accrual basis of accounting effective on January 1, assuming no objection raised by the Consumer Advocate or the Commission. This vastly simplified I minus X approach would replace the complex dual path traditional and capped RAM calculations that have historically been required for each utility.

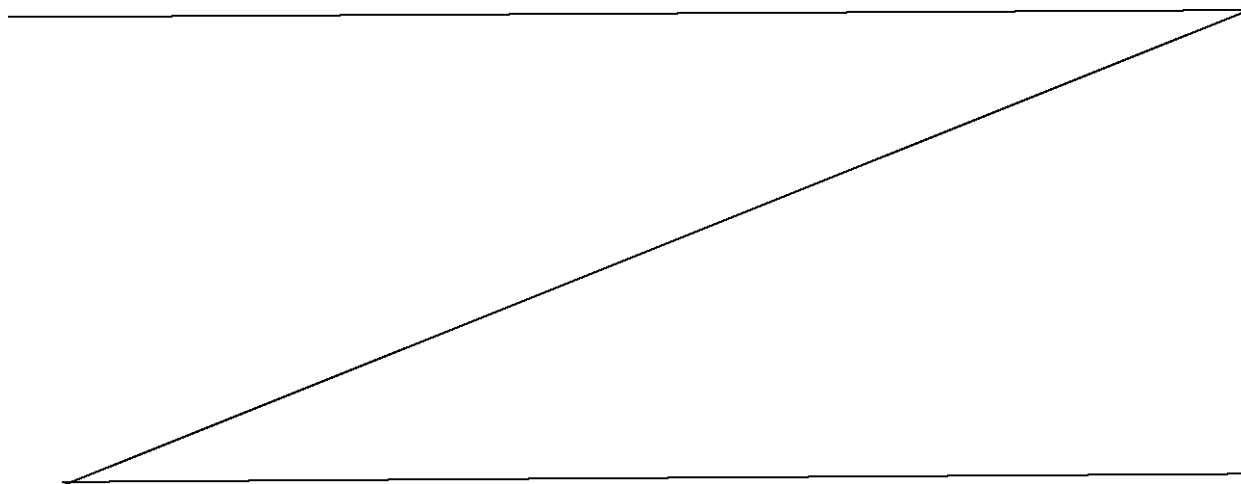
By March 31 of each year, a comprehensive filing should be submitted by each utility to document and present:

- 1) the reconciliation of revenue decoupling entries for the prior calendar year,
- 2) necessary updates or revisions to the abbreviated ARA target revenue filing on December 1,
- 3) calculations of prior year return on equity and ESM results on a ratemaking basis of accounting,
- 4) a summary of cumulative MPIR/MPSR increases to target revenues approved to date by the Commission,
- 5) achieved performance documentation and calculations to apply all Commission-approved PIMs, and SSMs, and
- 6) any proposed rate design changes approved by the Commission in other dockets or as needed to move surcharge recoveries into base rates.

The detailed formulation of these filings could build upon the “template” now in use for annual RBA/RAM filings each spring but should contain considerably more detail supportive of reported earnings and claimed performance mechanism results to enable an efficient review by the Consumer Advocate and Commission of such filings.

There is no compelling need to expedite the regulatory review of the comprehensive filings on March 31, since the utilities will begin accruing ARA increases effective January 1 and all other target revenue revisions for ESM, MPIR/MPSR and performance incentives can be recorded to the RBA balance as an accrual, for prospective recovery from or return to ratepayers at a later date. For the initial “round” of March 31 filings by each utility, an initial review period of no less than three months may be required that would yield a Consumer Advocate SOP at least by June 30, with a Commission Order modifying RBA rates issued thereafter. Annual RBA rate changes could be effective on August 1 of each year under this approach, with the accrual date for ARA increases to target revenue occurring earlier, on January 1.

The filing and review schedule proposed below may be revised after the first year, depending upon the level of complexity and controversy that is encountered in year one of PBR administration. The following table provides a template schedule showing a draft of proposed scheduling dates and intervals:



Potential Schedule Outline

Period	Date	Description
Year 1	December 1	Abbreviated ARA filing based on consensus GDPPI projections to adjust target revenues, with supporting documentation, for implementation on January 1 of Year 2.
	December 15	Consumer Advocate completes limited review of abbreviated filing (i.e., approximately two weeks) to support Commission order authorizing preliminary increase to be effective January 1.
Year 2	January 1	Company implements preliminary increase to target revenues, pursuant to abbreviated filing.
	March 31	Comprehensive filing by utility supporting and documenting RBA and ARA amounts, including: <ul style="list-style-type: none"> (i) revisions or corrections to abbreviated filing including update to GDPPI escalation rate, if necessary; (ii) reconcile revenue decoupling for prior year; (iii) present prior year ROE and ESM results; (iv) summarize cumulative MPIR increases for inclusion in target revenues; (v) provide detailed support for Z-Factor adjustment to target revenues with documentation for any qualifying changes or events; (vi) produce performance results documentation and calculations for approved metrics, scorecards, PIMs and SSMs; and (vii) proposed rate design changes approved by the Commission in other dockets.
	June 30	Consumer Advocate SOP due following review of comprehensive March 31 filing by each utility. <i>[After Year 2, the CA review period may be shortened depending on complexity of issues.]</i>

The utilities should continue the provision of monthly and annual financial reports now filed with the Commission and the Consumer Advocate, as well as the monthly “packets” summarizing RBA entries, to facilitate ongoing review of this information between annual formal filings. The Consumer Advocate also recommends the development, through collaboration with the utilities, of specific standardized filing requirements for reported earnings and ROE, that would be submitted with the March 1 comprehensive filings. These standardized Excel schedules and other documents would highlight budgeted and

actual monthly O&M and rate base investment fluctuations, providing narrative analyses of significant variances and should also include specific materials filed with the SEC and presented to the financial community that explain reported results. The goal here would be to reduce the need for burdensome discovery, while focusing attention upon the issues that most directly impacted earnings and upon documents already produced in the normal course of business.

More focused reviews of ECRC and PPAC-recoverable costs and management performance should also be undertaken, through redirection of regulatory resources historically dedicated to periodic rate cases. The Consumer Advocate intends to develop more detailed recommendations in this area in its future updated recommendations in this docket.

In general, performance mechanisms require a different approach to administration than MRPs. The Consumer Advocate has offered thoughts on how that process might be designed in Section IV.G., below.

The Consumer Advocate recommends that the performance mechanism reporting protocols should generally follow those described above for the ARA, ESM, and MPIR. The Consumer Advocate recommends that the Commission approved metrics should be made available on the Companies' website, just as the metrics approved in Docket No. 2013-0141 are currently posted. The information provided on the website should include the relevant historical data as well as targets, if applicable. Then, in March of each year, each utility should file a comprehensive set of reports providing information as

detailed in Section IV.G., below.⁷⁵ The Consumer Advocate would have three to four months to issue an SOP on the utility filings. Any adjustment to rates as a result of the rewards or penalties would be made at the same time that rates are adjusted for RBA, MPIR, ESM, and comparable adjustments.

IV. PERFORMANCE MECHANISMS.

A. BACKGROUND.

As discussed earlier, the Commission's Order No. 36388 identified core elements of an updated PBR framework launching the Phase 2 process, such as the three guiding principles and the three regulatory goals and twelve prioritized regulatory outcomes. For each Outcome, the Commission specifically indicated the nature of the Performance Mechanism it wished to be developed, and also provided direction and guidance for development of each type of proposed Performance Mechanism.

Through the RMI-led stakeholder working group process over the past months, the Commission has provided several additional elements of guidance. The Commission directed that outcome-based incentives be considered for each relevant outcome. Stakeholders were encouraged to explore alternatives to simple activity- or participation-based incentives. Adding to its earlier guidance, the Commission also requested that in light of the magnitude of possible desirable reductions in ECRC and/or PPAC costs in proportion to the magnitude of utility earnings, Parties were encouraged

⁷⁵ Regardless of the process adopted for reporting and review of the performance mechanisms, the Consumer Advocate believes that comprehensive reports should be made part of the annual RBA/ARA filing to facilitate expeditious review.

to propose SSMs or PIMs that are indexed on, and incent reductions in, these costs. The Commission further clarified:

The commission encourages proposals for PIMs and/or SSMs to address the Cost Control “PBR outcome” addressing the components of utility revenues and expenses that are not included in ARA Revenues (i.e., target revenues). The scope of these components includes but is not limited to revenues and expenses recovered through the ECRC, PPAC and/or MPIR mechanisms, to be addressed individually, conjunctively, or in some combination. Addressing several specific matters posited by the Consumer Advocate, the Commission clarifies that it expects that such proposals should be designed to further supplement (rather than dilute) the cost control incentives provided by the revenue adjustment mechanisms, and to address and mitigate (rather than exacerbate) capital bias incentives. Since the invited proposals for PIMs and/or SSMs would address the components of revenues not addressed by the ARA formula, the Commission does not expect it to be necessary to substantially “re-work” the revenue mechanisms proposed thus far.

At the March 25, 2020 Performance Working Group meeting, the Commission noted support for “further development and specification of a PIM” for the GHG reduction outcome. The table below presents the Commission’s guidance on the appropriate mechanisms for each outcome, as provided in Order 36388 and subsequent direction during the working group process.

Table 1. Commission Outcomes and Tools

Regulatory Outcome	Commission Selected Tool(s)
Affordability (<i>Traditional / Enhance Customer Experience</i>)	Reported Metrics
Reliability (<i>Traditional / Enhance Customer Experience</i>)	Continue Existing
Interconnection Experience (<i>Emergent / Enhance Customer Experience</i>)	PIMs, Scorecard
Customer Engagement (<i>Emergent / Enhance Customer Experience</i>)	PIMs, Scorecard
Cost Control (<i>Traditional / Improve Utility Performance</i>)	PIMs, SSM, Scorecard
DER Asset Effectiveness (<i>Emergent / Improve Utility Performance</i>)	PIMs
Grid Investment Efficiency (<i>Emergent / Improve Utility Performance</i>)	SSM
Capital Formation (<i>Traditional / Advance Societal Outcomes</i>)	Reported Metrics
Customer Equity (<i>Traditional / Advance Societal Outcomes</i>)	Reported Metrics

Greenhouse Gas Reduction (<i>Emergent / Advance Societal Outcomes</i>)	PIMs, Scorecard
Electrification of Transportation (<i>Emergent / Advance Societal Outcomes</i>)	Reported Metrics
Resilience (<i>Emergent / Advance Societal Outcomes</i>)	Reported Metrics

B. CONSUMER ADVOCATE'S OVERALL APPROACH TO PERFORMANCE.

With the Commission's guidance and the intervening months of stakeholder conversation, the Consumer Advocate has reframed and evolved its recommendation to a framework for a portfolio of financial incentives mechanisms that reward outcomes (not inputs) demonstrating exemplary performance. As more fully discussed below, the Consumer Advocate recommends: (a) retaining only the existing negative PIMs for reliability and the symmetrical PIM for customer service; (b) retaining existing SSMs for renewables procurement and storage and for grid services and a modified version of the existing Energy Cost Recovery Clause (ECRC); and (c) supplementing the portfolio with five (5) additional SSMs focused on the two areas of utility performance most demonstrative of innovation: DER Asset Effectiveness and Grid Investment Efficiency. This emphasis on both the mechanism of shared savings and these outcomes reflects the Consumer Advocate's position that performance incentives should encourage innovation and require proof of measurable achieved outcomes. A shared savings approach is preferred to PIMs because the earning opportunity with SSMs is proportional to the total savings generated by the utility, ensuring that the Companies only earn incentives by producing benefits. As discussed in detail below, the Consumer Advocate recommends that cost control be addressed through the existing or proposed SSMs. The Consumer Advocate does not propose any new incentives for the GHG reduction outcome. The Consumer Advocate has focused on its proposal of SSMs but continues

to evaluate PIMs that have been proposed by other parties as the Consumer Advocate recognizes that certain desirable outcomes do not lend themselves to savings or benefit quantification; thus, designing a SSM to align management actions with those types of outcomes will not be fruitful.

In making SSMs the core of its proposed performance incentive structure, the Consumer Advocate is building on the principles and precedents established by the Commission in previous dockets approving shared savings approaches for energy cost recovery, renewable energy and storage procurement, and grid services procurement. As the Commission noted in Order 36604 approving incentives for the Companies' Phase II RFPs, the record for SSMs as a regulatory tool and spur to innovation supports a continuation of this approach: "The results of the Phase 1 procurement process, including the timely submissions of the PPAs for commission review and low-cost energy procured, highlight the positive contribution the established PIM had in the overall Phase 1 competitive bidding process."⁷⁶ Furthermore, the Consumer Advocate contends that SSMs provide a transparent and balanced means of supporting incentives that might be paid to the utilities for exemplary performance since, in order to earn any incentive payments, the utilities must be able to quantify the benefits that have been delivered to customers. Thus, incentives are paid to the utility only if customers have clearly benefitted and the justification for the incentives will have been clearly laid out when the SSMs and the targets were implemented.

For the new shared savings mechanisms, the Consumer Advocate adds the caveat that prior to the adoption of an SSM under the MRP, it will be necessary to confirm that the outcome concerned involves a measurable customer benefit or system savings

⁷⁶ Order 36604. Pg. 17.

that does not otherwise benefit the Companies. To the extent that savings accrue only to the Companies – for example, through reducing the costs of operations – no additional incentive is needed or appropriate. Examples of cases where a shared savings approach may be appropriate include: (a) achievement of savings through reductions in costs or expenses for operations, investments, programs, or other initiatives funded outside the ARA; and (b) achievement of new savings or benefits *for* customers through means other than reducing costs or expenses outside the ARA.

While the structure of each incentive is discussed below, due to a lack of available data, the Consumer Advocate reserves any recommendation as to the appropriate level of sharing for each SSM. At this time, the Consumer Advocate expects that the implementation of individual shared savings mechanisms will continue to be handled in separate dockets in which supporting data will be shared but emphasizes the importance of the Commission remaining mindful of the totality of the incentive portfolio, and any overall earnings cap, in determining future earnings opportunities for the individual incentives. By continuing with the status quo approach of administering SSMs in dedicated proceedings, the Commission can provide for a more efficient and effective process with up-to-date performance data and mature proposals from stakeholders to inform its regulatory process.

As described in above in the revenue mechanism discussion, the Companies will have an opportunity to earn their authorized rate of return under the MRP. The Consumer Advocate recommends that the entire initial portfolio of financial incentives, existing and proposed, be calibrated such that the Companies must achieve exemplary performance in order to earn incentives. Consistent with the fourth Staff Report filed on

February 7, 2019, the Consumer Advocate recommends that the total incentive earnings opportunity be designed to provide the utilities up to 200 bps of additional earnings.

In addition to PIMs and SSMs, the Consumer Advocate continues to advance a robust set of scorecards and metrics, largely consistent with the Consumer Advocate's first update in January.

C. Performance Incentive Mechanisms.

The Consumer Advocate recommends that the existing reliability call center PIMs be retained but does not propose any new PIMs. Under the current framework, the Companies face downside-only incentives for SAIDI, SAIFI, and may receive either reward or penalty for call center performance. The Consumer Advocate's proposed PIMs are presented in the table that follows.

Table 2. Consumer Advocate's Proposed PIMs

Outcome	Description	PIM/SSM	Target/Baseline	Status
Customer Engagement	Call center performance	PIM	Rolling average of historical performance; no backsliding	Proposed
	SAIDI (mins)	PIM	Rolling average of historical performance; no backsliding	Proposed
Reliability	SAIFI (occurrences)	PIM	Rolling average of historical performance; no backsliding	Proposed

1. Reliability.

The existing reliability PIMs appear to be functioning well and are consistent with measures used across the country. Performance targets have been set for each of the Companies in recent cases but the Consumer Advocate raises a general concern about the current target-setting approach. As targets are set based upon historical performance, declining reliability can result in falling standards – an outcome that materialized in Docket No. 2018-0368 for HELCO. By allowing HELCO's reliability performance targets to fall, the Commission essentially enables service erosion.

The Consumer Advocate is unconvinced by the Companies' justification for this protocol. In their reply statement of position in Docket No. 2019-0110,⁷⁷ the Companies suggest that basing reliability performance targets on historical performance is appropriate since the aim of the reliability PIMs is to prevent erosion of service between rate cases – implying that meeting targets equates to preserving status quo reliability, but ignoring the basic point that if the targets themselves are eroding, service reliability is declining. Taken to the extreme, the Companies' argument in favor of rolling historical averages would suggest that the Commission continue to condone future service degradation, and could even incent adverse strategic behavior whereby: 1) the Companies could gradually decrease expenses meant to maintain service reliability in order to avoid penalties to further lower service standards; or 2) the Companies would willingly incur penalties in one period for poor service in the interest of lowering future service standards.

⁷⁷ In this proceeding, the Companies sought to modify the PIM tariffs to modify how reliability performance was measured and calculated.

The Consumer Advocate is also not convinced by the Companies' assertion that the downside-only structure of the reliability PIMs produces functionally higher performance targets, since the Companies can expect to incur financial losses if they do not improve performance relative to historical standards. This assessment relies on an assumption that annual reliability performance follows a normal distribution and exhibits significant stochasticity beyond the Company's control. It is not clear that reliability performance in fact exhibits such a distribution, and in any case, the purpose of any PIM is to provide incentives within the locus of control.

The Consumer Advocate stresses that the Companies should be required to maintain reliability. The Consumer Advocate maintains its recommendation from previous filings that future reliability targets should not be based merely on recent historical averages. Instead, the Commission should consider establishing reliability targets that are based on the Companies being within, for example, the top quartile of electric utility companies. Alternatively, reliability targets might be set based upon the Companies' historical performance, but with a "no backsliding" provision that does not permit targets to fall. Under such an approach, reliability targets would continue to be calculated based upon a rolling average of reliability performance over eight historical quarters, but with one caveat: if the rolling average of the eight quarters would result in a decrease of the target, the existing target would not be modified.

The Consumer Advocate also recommends that CAIDI and MAIFI continue to be tracked as Reported Metrics with the possibility that an additional metric, such as CAIDI, be considered for future PIM treatment. As highlighted in the discussion in Docket

No. 2019-0110,⁷⁸ the current reliance on PIMs targeting performance measured by SAIDI and SAIFI do not fully measure the customer experience. SAIDI and SAIFI are measures that focus on the measured duration and frequency of outages that are related to transmission and distribution events. The Consumer Advocate believes that there should be further evaluation of a PIM that targets improving the customer experience with outages – tracking all outages that are controllable by the utility – by decreasing such outages.

2. Call Center Performance.

The Consumer Advocate recommends that the existing call center performance PIM be carried forward but also raises concerns about the approach to formulating targets for this measure. Similar to the target-setting process for the reliability measures, call center performance targets for the Companies are based upon historical results. Benchmarking future performance targets to historical performance can lead to unintended consequences, such as enabling eroding performance. The Consumer Advocate contends that incentives should not be awarded for business as usual performance and continuing to allow the current target enables significant rewards for non-extraordinary performance. As the Consumer Advocate noted in its Statement of Position filed in response to the Companies' 2020 annual decoupling transmittal, a better approach to setting targets based on historical performance would include a “no backsliding” provision to the effect that performance targets could never fall. As noted

⁷⁸ See, e.g., the Consumer Advocate's Statement of Position filed in Docket No. 2019-0119 on October 18, 2019.

above, if the current method of calculating the targets is unmodified, it could lead to undesirable consequences.⁷⁹ For this PIM, given that there are also upside awards that are possible, besides the two possibilities already identified, another undesirable consequence could be that a utility could allow a cycle of gradual erosion of performance to set up a significant performance award by restoring service levels to a previously achieved level.

In addition, as the Consumer Advocate noted in its comments on the Companies' 2020 decoupling transmittals, the achievement of maximum reward levels at HECO with no rewards for either HELCO or MECO, as occurred in 2019, is unusual since the Companies rely upon a consolidated and virtualized call center with disbursed personnel having capabilities to handle calls for all three utilities. The Consumer Advocate recognizes that the Commission addressed the Companies' proposal to have a consolidated target for all three companies in Order No. 34566, filed on May 24, 2017, in Docket No. 2013-0141, but the Consumer Advocate believes that the time might be ripe to revisit whether a consolidated target, coupled with the proposed ratchet to ensure no backsliding, should be implemented. Based on recent experience for each company, the Consumer Advocate believes that the Companies could have a uniform call center performance target to reflect the expected consistency of performance that should be associated with a consolidated call center that is supported by recent historical experience, to avoid enabling a situation where one or more companies may be allowed to have lower targets than a company(ies) with higher performance, and, if the

⁷⁹ As noted earlier, potential unintended and undesirable consequences could include: 1) the Companies gradually decreasing expenses to generate savings that it would retain that would result in a gradual erosion of performance that would not trigger any penalties; and 2) the Companies could allow performance erosion that would trigger a penalty in order to erode performance targets.

proposed ratchet is adopted, would ensure that there would be no backsliding for any of the companies either individually or as a whole.

3. Framework For Establishing Performance Targets.

Both PIMs and scorecards will provide the Companies with specific performance targets. Setting goals and tracking outcomes may be both empirically and financially demanding. The Consumer Advocate therefore urges the Commission to adopt principles for establishing targets.

As a first-level principle, the costs of collecting and reporting data for the performance standard should be balanced with the benefit of the performance standard to customers. Though crisp quantitative data may not always be available to evaluate the value proposition of establishing performance targets, customer surveys can provide critical indications of consumer value (e.g., whether the additional cost is worth the additional reliability).

Secondly, the performance standard must be realistic. This means beginning with an understanding of the utility's current level of performance. Historical utility-specific data should be mined to identify accurate benchmarks. As mentioned in the Consumer Advocate's comments filed on May 8, 2018, it is imperative for the parties to have sufficient data to establish targets and PIM levels that encourage improvement rather than rewarding and reinforcing business as usual. Consequently, time may be

required for the collection of data before establishing benchmarks or implementing Scorecards or PIMs that rely on data not currently collected.⁸⁰

Once the baseline performance level is understood, targets will be set. Several streams of data may influence the targets, including:

- The historical performance of the Companies;
- The past performance of peer utilities;
- Performance data from adjacent industries such as the water, wastewater, and gas sectors; and
- Data from unrelated sectors, provided it relates to a shared functional area (e.g., call center performance).

Since targets are necessarily normative in directing the Companies toward desired outcomes, existing statutes, policies, and company commitments should be considered. Finally, it may be worthwhile to direct the Companies to commission expert prepared reports to guide performance standards. Examples of such documents include engineering and management consultant reports.

While the Consumer Advocate urges the Commission to rely upon data to establish meaningful performance standards, the exercise is as much art as science. For that reason, risk mitigants, such as deadbands, can be used to account for the necessary lack of precision in selecting suitable performance standards.

⁸⁰ Division of Consumer Advocacy's Comments on Preliminary Scope and Proposed Process, filed on May 8, 2018, at 9 – 10.

D. SHARED SAVINGS MECHANISMS.

The Commission has found the time to be ripe for development of shared savings mechanisms focused on addressing the Outcomes of Grid Investment Efficiency and Cost Control. As defined by the Staff Proposal, SSMs “reward a utility for reducing expenditures from a baseline or projection by allowing it to retain a portion of the savings as profit while returning the remainder to ratepayers.”⁸¹ SSMs provide an opportunity to incent Companies to pursue cost-effective solutions to meet customer needs and to address utility capital bias, and recent experience with the incentives for competitive procurement of grid-scale renewable energy generation is an example of how SSMs can be used to align utility management actions with desirable outcomes. As mentioned earlier, the Consumer Advocate contends that SSMs are perhaps the best incentive mechanism to ensure benefits are delivered to customers since, by their very nature, SSMs require the quantification of delivered savings or benefits in order to justify incentives to be paid for superior performance towards desired outcomes.

As a general principle, the Consumer Advocate recommends that shared savings mechanisms for cost control are appropriate only when other incentives to cost control under the MRP are not available. That is, if the Companies would retain the savings as a function of the MRP, then shared savings will generally not be appropriate. A key exception to this rule may be found in cases where customer savings are not entirely related to utility savings, such that incentive already exists for the Companies to reduce their own costs, but the Companies might take additional actions or make additional outlays to generate separate customer savings.

⁸¹ Staff Proposal. 49-50.

The Consumer Advocate also recognizes that SSMs must be carefully designed to avoid encouraging the development of overestimates of capital project costs or programmatic expenses to maximize the likelihood of favorable (to the utility) comparisons between the baseline/projected costs and the selected alternative. In other words, since SSMs are generally based on actual results compared to some estimated cost level, this counterfactual exercise could encourage a utility to provide inflated estimates to increase the likelihood of financial incentives. Thus, there will be a definite need for discipline when designing any SSM. The Consumer Advocate's recommended SSMs are presented in the table that follows.

Table 3. Consumer Advocate's Proposed SSMs

Outcome	Description	PIM/SSM	Target/Baseline	Status
Cost Control	Energy Cost Recovery Clause (ECRC)	SSM	Target heat rate and baseline fossil fuel costs	Existing
	Shared savings from energy from DER procured through tariffs, programs, or other means	SSM	Superior performance relative to baseline trajectory – e.g., that set by IGP process	Proposed
DER Asset Effectiveness	Shared savings from grid services from DER procured through tariffs, programs, or other means	SSM	Superior performance relative to baseline trajectory – e.g., that set by IGP process	Proposed
Grid Investment Efficiency	Phase II PIMs	SSM	Benchmark energy, storage, and grid service avoided costs	Existing
	Shared savings from utilizing AMI for grid needs	SSM	To be determined	Proposed

Shared savings from utilizing voltage optimization for energy savings	SSM	To be determined	Proposed
Shared savings from NWA over traditional solution	SSM	To be determined	Proposed

1. Existing SSMS.

The Companies currently enjoy shared savings earnings opportunities through the SSMS for the Companies' Phase II renewable energy procurements resulting from Docket No. 2017-0352, approved by the Commission in Order 36604, filed on October 9, 2019, in that same docket. The Companies may also retain savings from generation efficiency and fossil fuel cost savings under the ECRC. The 2017-0352 Phase II SSMS include two components: an incentive for savings from renewable energy or paired renewable energy and storage procured through a PPA, and an incentive for procurement of standalone generation or grid services through PPA. While the first incentive has been carried over from the 2017-0352 Phase I procurement framework, the second shared savings mechanism is new. The Consumer Advocate supports these incentives earnings opportunities, and notes that they must be taken into consideration in calibrating the value of any additional incentive opportunities. The Consumer Advocate believes that these examples provide the basis for the proposal that SSMS are an effective means of providing incentives to align Companies' actions with desirable outcomes that benefit customers. These examples are also the basis for the Consumer Advocate's response to the Commission's guidance for incentives for cost controls, especially for the ECRC and PPAC. That is, rather than developing a systemic or programmatic PIM or SSM for

cost control or to develop a separate incentive mechanism that might confound efforts and expected results from the ARA mechanism, the Commission should rely on SSMS to encourage cost control and lower prices when the utilities are seeking new renewable capacity or energy; the relevant SSMS could be developed in the relevant application that will be filed when such capacity or energy is sought.

The ECRC mechanism is successor to the ECAC. In Docket No. 2016-0328, the Consumer Advocate raised several concerns about the design of HECO's ECRC, including issues with the fossil fuel cost risk sharing component. As other concerns that were noted – on the ECRC review process, the frequency in changes to the recovery factor, and the exclusion of the fossil fuel cost risk sharing from the RAM tariff calculations – have been addressed previously by the Commission, the focus here is on the fossil fuel risk sharing component.

The Consumer Advocate reiterates its concern that since the Companies are essentially price-takers on the global market for fossil fuels and wield no meaningful influence on fuel prices, sharing savings or overages on fossil fuel means that the Company stands to gain or lose based on factors outside its control – a violation of a cardinal principal of incentive design. While it was argued in Docket 2016-0328 that sharing cost deviations could induce the Companies to adopt a more strategic financial position to guard against downside risk, the existing sharing framework could also conceivably produce undesirable outcomes, such as the Companies increasing reliance on fossil fuels during low-cost periods to maximize earnings through the ECRC.

Evidence of the fault in the design of the ECRC can be seen in the Companies' recent experience with fuel sharing under COVID-19. The fossil fuel risk sharing

component of the ECRC means that the Companies are likely to receive increased revenues as a result of the significant decrease in global fossil fuel prices due, in large part, to the soft demand for those resources as well as the ongoing price war between Russia and OPEC – factors that are completely outside the Companies' control. Yet, based on available data, it is possible that the Company will stand to recover the maximum amount allowed under the current ECRC incentive mechanism and such benefit will be recoverable from customers in the next annual decoupling filing, which will be an undesirable and unfortunate impact on customers' bills as they are likely to be still recovering from the economic impact of the current pandemic. The Consumer Advocate notes that this outcome signals a failure in the ECRC design and this is an example of how modifications to the incentive should be evaluated and considered to ensure that the Companies are not provided incentives that are not aligned with desirable outcomes. Along those lines, the Consumer Advocate suggests that the time is right to consider modifications, such as removing or modifying the fossil fuel cost risk sharing component from the ECRC. If the Commission believes that some incentive to encourage the Companies to reduce their reliance on fossil fuels beyond the achievements that are expected as the Companies comply with the RPS, the Commission might consider modifying the incentive to target the relative volume of fossil fuel consumed, instead of price paid or total expenses incurred; such a modification would be more in alignment with the stated objectives of encouraging movement away from fossil fuel use.

2. New SSMS.

(a) SSM for DER Generation.

The Companies have a number of existing tariffs to procure generation from DER: Net Energy Metering (NEM), Net Energy Metering Plus (NEM+), Community Grid Supply (CGS), Feed-in Tariff (FIT), and Community Based Renewable Energy (CBRE). The Companies have no CBRE enrollment at present and the other programs, such as NEM, CGS, etc. have represented the majority of contributions and participation in DER programs.

DER is an integral component of the Companies' plan to achieve Hawaii's renewable energy goals. At the present time, the 2016 PSIP offers the most up to date role of DER in the Companies' future operations. The following targets for incremental DG PV for the companies were identified for the period 2017-2021:

Table 4. Plans for Incremental DG PV

Island	Incremental PV (MW) Required by PSIP
O'ahu (MW)	255.1
Maui (MW)	38.4
Moloka'i (MW)	1.4
Lana'i (MW)	0.7
Hawai'i (MW)	30.3

Mapping these plans to the companies' service territories results in an expectation of 255.1 MW of new distributed solar for HECO, 40.5 MW of new DG PV for MECO, and 30.3 MW of new DG PV for HELCO. Consistent with objective of establishing outcome based targets and to reward exemplary performance, the Consumer Advocate

supports efforts in future DER proceedings to explore the possibility of developing an SSM or SSMs that would allow the Companies to receive an incentive for cost-effective delivered energy and capacity beyond baseline forecasts from DER sources.

The Consumer Advocate recommends that the existing incentive for procurement of energy through PPAs be maintained separately from the proposed incentive for savings from DER energy, as the existing SSM concerns utility-scale generation resources, while the proposed SSM here relates to customer-sited small resources. The Consumer Advocate re-emphasizes that the development of a SSM for DER procurement must be performed in conjunction with an overall review of the portfolio of incentives to mitigate the possible risk that the Companies might be presented with the unintended consequence of superior incentives for procuring energy from DER from one or more programs, as compared to other DER sources or even utility scale sources. It is for that reason that it is the Consumer Advocate's position that the goal should be to align these SSMs to the degree possible.

(b) SSM for Grid Services from DER.

The Consumer Advocate's proposed shared savings mechanism for grid services will provide the Companies with earnings opportunities for savings from procurement of grid services from DER sources. The Consumer Advocate notes that the existing Phase II PIM for DER grid service procurement from third-party aggregators is likely to continue, and therefore restates its position that the proposed incentive and the existing one should be made to align to the degree possible.

Grid services include the four functional categories acknowledged by the Commission in Docket No. 2015-0412 in its approval of a Demand Response portfolio tariff structure for the Companies – fast frequency response (FFR), regulating reserve (RR), Supplemental Reserve, and Capacity.⁸² Currently, the Companies have several tariffs for grid service tariffs including CIDLC, RDLC, SBDLC, GIWH, Fast DR, and FFR. The Consumer Advocate recognizes that this structure is likely to be revised in the coming years; grid services procured through new programs and tariffs, including those for standalone storage and paired renewable energy and storage should be counted toward this SSM.

In the Phase II docket, the Commission implemented two requirements for storage to qualify for the grid services incentive: (1) The delivered cost of electricity from standalone service projects must be at least 20 percent less than the average avoided cost of electricity for that calendar year; (2) GHG emissions from delivered energy from standalone storage must be at least 25 percent lower than GHG emissions of the capacity resource being replace.⁸³ The Consumer Advocate proposes that these requirements be attached to the new grid service SSM too.

At this time, the Consumer Advocate agrees with the notion that shared savings should be determined based on the difference between actual costs incurred and avoided costs, using regularly updated value-of-service results. It is for this reason that the Consumer Advocate has been encouraging more progress in the market track in Docket No. 2014-0192 so that estimates and surrogate pricing for unbundled ancillary and grid

⁸² Order 36499. Pg. 3.

⁸³ Order 36604. Pg. 31.

services can be developed instead of relying on gross estimates of avoided capacity and energy costs. In addition, as the Consumer Advocate noted in Docket 2017-0352, using stale data may run counter to the public interest by distorting savings calculations.⁸⁴ Because this is a relatively new performance area, the Consumer Advocate acknowledges that the absence of data and experience may support the need for lower baseline and target levels in the beginning until more data regarding possible performance levels can be acquired and evaluated.

(c) SSM for AMI Utilization.

Advanced metering infrastructure (AMI) can reduce operational costs and provide the vehicle for expanded grid services and programs.⁸⁵ The Companies are able to reduce operational costs such as meter reading and connections or disconnections. They enjoy more successful revenue collection through the availability to offer pre-pay billing or reduce meter tampering and increase theft detection. These operational costs savings and revenue collection enhancement benefits will be enjoyed by the Companies and captured under the structure of the MRP. The Companies may also use AMI for developing new programs, service offerings, and other features such as voltage

⁸⁴ Docket 2017-0352. Division of Consumer Advocacy's Motion to Seal Division of Consumer Advocacy's Comments Regarding the Hawaiian Electric Companies' Phase 2 Draft Requests for Proposals, Filed on May 20, 2019. Pg. 9.

⁸⁵ See "Advanced Metering Infrastructure and Customer Systems: Results From the Smart Grid Investment Grant Program" (DOE, September 2016) https://www.energy.gov/sites/prod/files/2016/12/f34/AMI%20Summary%20Report_09-26-16.pdf; and St. John, Jeff "Distributech Spotlight: Hawaii's Interoperable Grid Communications and Next-Gen Grid Planning" (GTM, February 8, 2019) <https://www.greentechmedia.com/articles/read/distributech-spotlight-hawaiis-interoperable-grid-comms-next-gen-grid>.

monitoring in support of grid control. These types of benefits may or may not produce savings within the ARA. To the extent the Companies achieve savings or produce new benefits through deployment of AMI that are enjoyed only by customers (e.g., reduced energy costs), the Consumer Advocate believes that evaluation of a shared savings mechanism (or mechanisms for different programs) may be warranted to encourage the Companies to develop such programs to deliver benefits to customers even if the Companies would not directly benefit through the ARA. Because this is a relatively new performance area, similar to the recommendation offered earlier, the Consumer Advocate suggests that any performance benchmark may need to be conservative until further experience and data is available.

(d) SSMs (2) for Voltage Optimization.

Voltage optimization can be utilized to enhance distribution system peak capacity for better integration of distributed renewable generation⁸⁶ or to reduce the amount of energy a customer needs to provide the same level of service, saving the customer energy and money.⁸⁷ To the extent that the Companies utilize voltage optimization to enhance distribution system peak capacity, the Consumer Advocate recognizes that the Companies are likely to enjoy savings within the ARA. As such, the Consumer Advocate does not recommend an SSM for peak capacity gains through voltage optimization.

⁸⁶ Press Release “Hawaiian Electric to deploy Varentec’s grid edge voltage reduction technology for increased rooftop solar grid capacity” (December, 19, 2017) <https://varentec.com/hawaiian-electric-deploy-varentecs-grid-edge-voltage-regulation-technology-increased-rooftop-solar-grid-capacity/>.

⁸⁷ “Voltage and Power Optimization Saves Energy and Reduces Peak Power” (Department of Energy, September 15, 2015) <https://www.smartgrid.gov/document/Voltage-Power-Optimization-Saves-Energy-Reduces-Peak-Power.html>.

However, The Consumer Advocate recognizes that investigation of two separate shared savings incentives for voltage optimization might be worthwhile. To the extent the Companies use voltage optimization to provide additional distribution system capacity AND the funds to support the effort derive from outside of the ARA, the Commission might consider establishing voltage control SSMs to align utility actions with the objective of delivering the potential benefits even though it may not directly benefit the utility (e.g., through cost savings). Because the benefit of voltage control for energy savings is enjoyed almost exclusively by customers, this may be an example of a shared savings reward regardless of the source of funding for the program because, absent that incentive, the Companies may not aggressively seek to provide such benefits. Because this is a relatively new performance area, the Consumer Advocate again suggests that initial performance targets may need to be conservative until more data and experience is available.

(e) SSM for Non-Wires Alternative (NWA).

The potential promise of NWA have led to suggestions that the Companies should be provided with shared savings rewards when they deliver savings as the result of implementing non-wires alternatives to distribution system investment. Under the Consumer Advocate's proposed PBR framework, the utility companies should already be motivated to consider NWA as the existing bias to consider capital investments should be replaced by a careful evaluation to consider all cost-effective solutions to meet customer demand, including NWAs, so that the utility companies can maximize their earnings. For this area, any net savings realized through a NWA should be experienced by the utility companies but the Consumer Advocate recognizes that this is a relatively new

performance area and the Commission may want to evaluate whether what type of SSM may be appropriate, especially for NWA opportunities that may not be funded through the ARA (e.g., if the costs were recovered through the MPIR) so that there is more of an incentive to find the most cost-effective solution rather than assuming that the cost of the program will be simply passed along through a surcharge. Again, due to the fact that this is a new area, the Consumer Advocate suggests that any performance target be conservative until more data and experience is available. However, in determining the relative share of the savings, the Consumer Advocate will seek to ensure that the mechanism: 1) promotes the selection of the optimal solution; 2) does not promote the perpetuation of capital bias; 3) provides the Companies with an opportunity for an approximate level of earnings that might have been available under a traditional solution.

3. Performance Baselines.

As noted above, the Consumer Advocate holds that the Companies should be eligible only for incentive earnings for exemplary performance. The Companies should not earn a share of savings already delivered through past improvements nor should the Companies earn for merely complying with regulatory or statutory mandates. Ratepayer funds should not go to compensate shareholders for gains already achieved, or gains that would be achieved anyway in the absence of an incentive.

Nonetheless, establishing the appropriate future baseline for shared savings is likely to be challenging. The Consumer Advocate's SSM mechanisms are proposed to incent transformational utility behavior. While the Companies are directed to increase DER penetration, roll-out AMI, and generally modernize the grid, the Consumer Advocate

believes that it may be incumbent upon the regulators to ensure that the requirement are not only met but that the Companies are urged to aggressively seek the delivery of customer benefits. Thus, the Consumer Advocate acknowledges that providing incentives to the Companies out of any new savings may better align the Companies' interests with the transformational goals.

E. SCORECARDS.

The Consumer Advocate proposes a set of scorecards for the outcomes of Customer Engagement and Customer Equity. While the Consumer Advocate believes that providing incentives for these outcomes should be considered, given the lack of relevant data and inability to quantify savings, the Consumer Advocate believes that scorecards should be used in the interim to facilitate the collection of relevant data for future evaluation for possible incentives while still providing a means to measure utility performance in these areas. The recommended scorecards provide explicit regulatory guidance to the Companies to meet targets for AMI installation and functionality, enroll customers in TOU rates, ensure that customers utilize the online customer portal, and work to improve arrearage program outcomes, reduce service disconnections, and expand LIHEAP coverage for low-income customers. The Consumer Advocate believes that scorecards are appropriate where target outcomes are important but are not suited to an incentive – either because outcomes cannot be satisfactorily valued, or because targets are preliminary or provisional. Recommended scorecards are provided in the table that follows.

Table 5. Proposed Scorecards

Outcome	Description	Target
Customer Engagement	Percent of customers with AMI	Based on schedule in Companies' June 2018 application
Customer Engagement	Percent of customers with access to Green Button Connect functionality	All customers with AMI
Customer Engagement	Percent of customers participating in time sensitive tariffs	To be determined
Customer Engagement	Percent of all customers using customer portal, and percent of LIHEAP customers using customer portal	Baseline to be established; LIHEAP customer target should be identical to target for all customers
Customer Equity	Percent of arrearage plan participants making timely payments (% of participants)	Current timeliness should be maintained
Customer Equity	Percent of customers served by LIHEAP (% of eligible customers)	Baseline to be established; targets should require moderate year-on-year increases
Customer Equity	Total disconnections for nonpayment by residential customers	Baseline to be established; targets should require modest year-on-year reductions

F. REPORTED METRICS.

The Consumer Advocate recommends establishing several Reporting Metrics for each of the desired outcomes identified in this docket. The Consumer Advocate believes that Reporting Metrics offer a low-cost, low-risk way to monitor utility performance and that it is important to establish a set of relevant metrics that best measure utility performance for each of the identified outcomes.

Carefully designed metrics are the bedrock of successful performance-based regulation. Metrics provide foundational support for Scorecards, SSMS, and PIMs. They provide the information that utilities and others can use to identify performance areas that might warrant additional regulatory attention. In the Commission's envisioned regulatory system, metrics represent the key means through which the Commission, the Consumer Advocate, and other stakeholders can evaluate utility performance in the key identified outcomes as well as in other areas. Metrics that are properly identified and designed offer significant benefits in terms of regulatory oversight and customer protection but impose few costs or risks to customers. Each of the metrics should provide valuable insight into utility operations and might suggest that additional inquiry is warranted or that utilities need to modify their activities to achieve desired outcomes.

The Consumer Advocate has balanced these prioritized metrics to make sure that there is a reasonable number of metrics for each outcome and the package of metrics makes sense as a whole. The Consumer Advocate also assessed whether the package of metrics is adequate to support the goals of power sector transformation. The litmus test used by the Consumer Advocate was whether the portfolio of metrics captures and measures the essence of the utility performance required to transition from a centralized fossil-fuel based system to the desired future state of a system based upon abundant and affordable renewable energy and distributed energy resources. To accomplish this, the Consumer Advocate considered the Commission's framing of emergent regulatory outcomes, industry knowledge, potential available data, and a review of evolving performance-based practices in other jurisdictions. The result, presented in the table

below, is a refined portfolio of metrics that will both protect customers from the erosion of traditional regulatory outcomes and drive transformation beneficial to customers.

Table 6. Proposed Metrics

Outcome	Description
Affordability	Average bill as percent of income, low income residential customers (0-100% of Federal Poverty Level)
	Average bill as percent of income, all residential customers
	Average bill as percent of income, moderate income residential customers (60-80% median income)
	Percent of all customers making timely payments
Capital Formation	Households that cannot afford to interconnect to the grid (# of Households)
	Credit Ratings
Cost Control	O&M costs per customer (\$/cust), by class
	Rate base per customer (\$/cust), by class
	Unaccounted for energy
	Third-party Consumer Satisfaction Survey (JD Powers or other)
Customer Engagement	Consumer Energy Literacy
	Percent EV participation in TOU rates (%)
	Percent of customers participating in an energy efficiency program managed by Hawaii Energy
	Number and percent of customers participating in each Company-administered program or tariff
Customer Equity	Percent of LIHEAP Subscribers participating in CBRE
	Percent of LIHEAP customers per utility participating any energy program (e.g., NEM, NEM+, CGS, CGS+, CSS, CBRE, TOU)
DER Asset Effectiveness	Estimated reductions in CO2 emissions related to load shifting enabled by DER

Electrification of Transportation	Estimated change in short-run costs using the calculated marginal cost of energy
	Estimated change in long-run costs using a capacity expansion model that calculates long-run fixed investment and marginal operational costs
	Number of building participating in whole building DER program
	Percent of customer sited resources utilized for grid operations (third party meters, advanced inverters, storage, etc.)
	Estimated energy curtailed from DER as a percent of DER contribution to the grid by utility
	Estimated curtailed energy as a percent of available IPP curtailable energy by utility
	Total kWh using smart charging rates at EV charging stations as measurable by utility
	Total kWh at EV charging stations as measurable by utility (Rates EV-U, EV-F, E-BUS-J, E-BUS-P or successor or similar tariffs)
	Annual CO2 emissions per energy (tons/MWh)
	Annual CO2 emissions (tons)
GHG Reduction	
Grid Investment Efficiency	Total \$ value of projects for which the utility seeks an NWA / total \$ of projects undertaken that year (with a value over \$x)
Interconnection Experience	Interconnection time (days), by DER and IPP
Reliability	MAIFI (occurrences)
	CAIDI (mins)
Resilience	Percent of circuits with automation or remote-control equipment including monitor or control via SCADA systems (Distribution management systems or enhanced outage management systems)
	SAIDI, SAIFI, and MAIFI by circuits
	SAIDI, SAIFI, CAIDI response time on black sky days
	Length of time critical customers are without utility power on an annual basis

Number, description, and location of all critical customers (e.g., fire and police departments, hospitals, clinics, vulnerable customers)

Restoration: % of circuits with intelligent reclosers

G. REGULATORY REVIEW AND CONTINUOUS IMPROVEMENT.

Financial incentives, whether PIMs or SSMs, should be reviewed periodically to determine whether they continue to meet regulatory goals. The Commission should establish a process to enable modifications of PIMs/SSMs on an on-going basis if they do not serve their intended purpose or are not efficient or equitable. This flexibility to evaluate or redesign PIMs/SSMs should balance the two goals of: (a) providing utilities with the regulatory certainty to make financial decisions that may result in long-term commitments, such as a long-term service agreement or a capital investment, and (b) modifying the PIM/SSM over time to adjust to changing circumstances and lessons learned.

The Consumer Advocate recommends that this review should occur annually. The Consumer Advocate believes that there are different options that bears further discussion regarding the implementation. For instance, one option is to have that annual report as part of the annual decoupling tariff transmittal, which would facilitate a more holistic review of both the RBA/ARA mechanisms as well as the PIMs/SSMs within the same review. If this option is pursued, it is likely that additional time should be allocated to facilitate the review of the report and the likely discovery that will be necessary. If this alternative is selected, it may have to be assumed that there would be a lag in implementing any modifications to the PIMs/SSMs that are deemed necessary. For example, if the 2021 twelve-month PIMs/SSMs data and experience is evaluated in the second to third quarter

of 2022 as part of the anticipated annual decoupling filing, any modifications to the PIMs/SSMs would become effective as of January 2023.⁸⁸ Another alternative could be that a performance incentive report would be filed in late third quarter or early fourth quarter of the year to facilitate a Commission decision before January so that any modifications could be made effective for the next calendar year. Using the example above, this might mean that the performance incentive report would be filed in late 2021 to facilitate a Commission decision to maintain the performance mechanisms and targets as is or adopt any modifications by January 2022 so that the utility companies would be aware of the targets throughout January through December 2022. This approach would eliminate the lag identified in the first approach but could create certain disjoints between the review of the PIMs/SSMs and RBA/ARA mechanisms and not facilitate a holistic review of both the revenue and performance mechanisms.

Regardless of the approach use, the report should include the Companies' assessment of its performance relative to any established PIM and the savings achieved within any SSM with a calculation of the incentive it believes it has earned including all underlying data presented in a transparent format. For each PIM/SSM, the Commission should consider the following areas of inquiry.

- Was the PIM/SSM defined clearly?
 - Is there confusion about achievement?

⁸⁸ Unlike the adjustments to the rates arising from the decoupling filing, consistent with the principle that changes should be made on a prospective basis, modifications to PIMs or SSMs should not be done retroactively. Otherwise, there will be no clear relationship or finding of efficacy of the PIM or SSM in encouraging or modifying utility behavior for past periods. In other words, if a modification is approved in July 2023 and made effective as of January 2023, the evaluating whether the efficacy of a modified PIM for the months of January and June 2023 is a wasted effort since the utility would be operating under the pre-existing form of the PIM.

- Is the data source for PIM/SSM documentation reliable?
- Is the data still readily available?
- Is the PIM/SSM effective?
 - Did the utility's actions align with achieving the desired outcome?
 - Did an intervening exogenous factor prevent, impede, or enhance the utility's perceived performance?
 - Was the PIM/SSM "gameable"?
- Is the PIM/SSM efficient?
 - Was it calibrated appropriately? (Would the utility have achieved the desired outcome with less of an incentive?)
 - Is the administrative effort to track and calculate the PIM manageable?
- Has the PIM/SSM promoted any unintended consequences?
- Will the PIM/SSM remain effective?
 - Has outlived its usefulness (i.e. when should a PIM/SSM be "retired")
 - Has performance in this area become industry standard?
 - Did the outcome become a statutory mandate?
 - Have other important outcomes superseded performance in this area?

As a part of the Commission's consideration of these questions, the Consumer Advocate recommends that the Commission invite comments from the Companies, the Consumer Advocate, and other parties or stakeholders. To support effective review, the Consumer Advocate recommends that procedures, similar to the

procedures that have been developed for the annual decoupling filing, should be implemented to facilitate the opportunity for parties to seek additional information about the Companies' performance and the possible corresponding awards or penalties. There should be some consideration of interim reviews to facilitate a quicker review of the annual report. For example, as described above, there is an established procedure where the Companies currently provide interim information and responds to "standardized" information requests as part of the RBA review in order to facilitate a quicker review of the annual report. For the PIMs and SSMs, the Consumer Advocate encourages the continued use of the Company's website to provide relevant data and information for PIMs, SSMs, scorecards, and metrics. Depending on the PIMs, SSMs, scorecards, and metrics, developing "standardized" information requests to which the Companies would provide responses when quarterly (or whatever applicable interval) data is posted on the website.

In the annual review, if the PIM/SSM is operating as intended, the Commission makes such a finding and authorizes continuation of the PIM/SSM. If the review discloses that one or more of the PIMs/SSMs is not effective in that it is: (a) not incenting the desired performance outcomes, or (b) incenting the desired performance but is inefficient or inequitable, then the Commission should consider modification of one or more PIMs/SSMs on a going forward basis only. The Consumer Advocate does not support a backward-looking adjustment of a PIM/SSM, except for in the case where utility fraud or gaming has been demonstrated.

To be clear, nothing in this review process is intended to suggest an “off ramp” for PIMs or SSMs.⁸⁹ That is, unless there are fatal flaws that are identified for a particular PIM or SSM, the Consumer Advocate believes that potential corrections and improvements from an annual review could be made, where necessary, to better align the utility performance to be consistent with desired outcomes. The Consumer Advocate believes that review and modifications to PIMs and SSMs are integral to the success of the overall PBR framework and do not represent a departure from it. For example, a SSM that is deemed successful by all at its inception will likely need to be modified at some point in the future as market conditions change, performance levels change, or other factors not known or available at the time of inception need to be considered. Thus, modifications should be expected, and off-ramps should not be required.

Similarly, the annual review process should allow for review and modification of the Reported Metrics and Scorecards. Performance information from the previous year should be reviewed to determine whether Reported Metrics or Scorecards should be modified, expanded, or eliminated to reflect recent experience, lessons learned, and evolving regulatory needs.

Regarding the Commission’s guidance inviting parties to consider the impacts of COVID-19 and how it might affect proposals, as discussed earlier, the pandemic highlighted the need to consider whether the Z-factor should be modified to account for national or state declared emergencies. The Consumer Advocate has also considered whether it might affect its performance mechanism proposals. The Consumer Advocate acknowledges that, depending on the PIM or SSM, a national and/or state emergency

⁸⁹ The term “off ramp” is being used in the context of discontinuing PBR and the incentive mechanisms.

could affect utility operations, consumer usage patterns, and other factors that might lead to skewed results. Such skewed results might, if PIMs, SSMs, scorecards, and metrics are evaluated in a vacuum, lead to misleading conclusions. For instance, given the anticipated decrease in customer electricity demand due to the ongoing pandemic, an annual report might show a significant decrease in GHG emitted by the companies but that decrease will not have been caused by any utility action. It is for that reason that the Consumer Advocate's proposed list of questions that should be considered in the annual review of performance mechanisms includes an evaluation of whether any exogenous factors might have affected the perceived performance. The Consumer Advocate does not believe that such exogenous factors support a conclusion that the pause button should be automatically pushed during any exogenous event. For instance, there are ongoing efforts to address a request within Docket No. 2019-0323 to facilitate the interconnection of DER systems during the pandemic to help the solar industry. It is possible that, depending on the PIMs or SSMs that are adopted, exemplary utility efforts to address this request could benefit both customers and the solar industry and an automatic suspension of incentive mechanisms might not be in the public interest. On the other hand, if there were a natural disaster that affected one or more islands in the state, it may be necessary to acknowledge that exogenous factor and consider the need for modifications that will affect a particular PIM or SSM. Rather than trying to craft generic or overly detailed exceptions to any PIM or SSM for an unknown exogenous event, the Consumer Advocate contends that the review process should incorporate flexibility and consider, when necessary, the impact that an exogenous event might have and the impact on any calculated incentive.

V. SUMMARY.

The above discussion offers the Consumer Advocate's Second Proposal Update that relied upon the Consumer Advocate's Initial and First Updated Comprehensive Proposals as a foundation, but this Second Proposal Update reflects expanded, enhanced, and/or informed positions facilitated by the discussions held in the various workshops and additional analysis since the initial and first updated proposals were filed. The Consumer Advocate believes that there may be further enhancements, refinements, and necessary modifications that should be expected. With the formal statement of positions due in June, there is an identified and urgent need to receive data and comments that would help further refine proposals.

In its initial and first updated proposals, the Consumer Advocate was hesitant to allocate significant efforts to detailing possible procedural processes due to the uncertainty of what and how mechanisms might be developed. The Consumer Advocate recognized, however, the need to provide a draft of possible procedures to help visualize the processes that will have to be adopted. In order to facilitate a timely adoption of PBR, the Consumer Advocate has offered such proposals to accelerate discussions on the possible processes in the rapidly closing window of opportunity before formal statements are to be filed.

As noted in earlier proposals, the Consumer Advocate has not prepared or presented in this Second Proposal Update any specific rebuttal arguments responsive to the PBR proposals of other parties. This should not be interpreted as acceptance of any positions not affirmatively addressed by the Consumer Advocate at this time. The Consumer Advocate continues to evaluate other proposals and is not only seeking areas

of disagreement but is also evaluating areas of alignment to determine where further improvements in the Consumer Advocate's proposal might be made. The Consumer Advocate looks forward to the last workshop and subgroup meetings to help highlight areas where the Consumer Advocate will need to focus before the June statement of position.

DATED: Honolulu, Hawaii, May 13, 2020.

Respectfully submitted,

By /s/ Dean Nishina
DEAN NISHINA
Executive Director

DIVISION OF CONSUMER ADVOCACY

CA Exhibit 1
ORIGINAL SHEET NO. _____
Effective _____, 2020

REVENUE BALANCING AND ANNUAL REVENUE ADJUSTMENT ("RBARA")

Supplement To:

Schedule R	- Residential Service
Schedule G	- General Service - Non-Demand
Schedule J	- General Service - Demand
Schedule DS	- Large Power Directly Served Service
Schedule P	- Large Power Service
Schedule F	- Public Street Lighting, Highway Lighting and Park and Playground Floodlighting
Schedule U	- Time-of-Use Service
Schedule TOU-R	- Residential Time-of-Use Service
Schedule TOU-G	- Small Commercial Time-of-Use Service
Schedule TOU-J	- Commercial Time-of-Use Service
Schedule TOU-P	- Large Commercial Time-of-Use Service
Schedule SS	- Standby Service
Schedule TOU EV-	Residential Time-of-Use Service with Electric Vehicle Pilot
Schedule EV-F	- Commercial Public Electric Vehicle Charging Facility Service Pilot
Schedule TOU-RI-	Residential Interim Time-of-Use Service

All terms and provisions of the above listed rate schedules are applicable except that the total base rate charges for each billing period shall be adjusted by the Revenue Balancing Account Rate Adjustments shown below:

A: REVENUE BALANCING ACCOUNT ("RBA") PURPOSE:

The purpose of the Revenue Balancing Account ("RBA") is to record: 1) the difference between the Hawaiian Electric Company's target revenue and recorded adjusted revenue, and 2) monthly interest applied to the simple average balance of the beginning and ending month balances in the RBA, net of income taxes, less 3) revenue recovery of prior period RBA balances through the Revenue Balancing Account Rate Adjustment.

The Revenue Balancing Account Rate Adjustment provision of this tariff provides for:

1. collection or return of the calendar year-end balance in the RBA,
2. recovery of the cumulative Annual Revenue Adjustment ("ARA"), as described herein,
3. Earnings Sharing Mechanism ("ESM") revenue credits or charges to customers calculated based upon previous calendar year financial results, as described herein,
4. Revenue adjustments provided in accordance with the Performance Incentive Mechanism Provision and other performance incentives approved by the Commission, and
5. Any other Commission-approved adjustments to recover or returned designated revenue amounts from or to customers.

CA Exhibit 1
ORIGINAL SHEET NO. _____
Effective _____, 2020

REVENUE BALANCING AND ANNUAL REVENUE ADJUSTMENT ("RBARA")

Revenue Balancing Account Rate Adjustments are to be effective over the subsequent August 1st through July 31st period.

1. Target Revenue:

For the purpose of RBA accounting, the target revenue is the annual electric revenue approved by the Public Utilities Commission in the last issued Decision & Order in the Company's most recent test year general rate case or other regulatory proceedings, excluding revenue for fuel and purchased power expenses that are recovered Energy Cost Recovery Charges or in a Purchased Power Adjustment Clause; excluding revenue being separately tracked or recovered through any other surcharge or rate tracking mechanism (e.g., DSM, DRAC, IRP); and excluding amounts for applicable revenue taxes;

Plus: Cumulative effective Annual Revenue Adjustments, calculated under the ARA Provision (or predecessor Rate Adjustment Mechanism, if applicable) for years subsequent to the most recent rate case test year for which the Commission has issued a Decision & Order; plus approved MPSR surcharges or credits; and any Performance Incentive Adjustment provided for in accordance with the Performance Incentive Mechanism Provision; and any applicable Earnings Sharing Mechanism surcharges or credits calculated under the ESM Provision.

Adjusted by: Other adjustments, as applicable, in accordance with a Commission Order authorizing such adjustment. Other adjustments, if any, are shown in the table *Target Revenue Currently in Effect*, provided in section F.

The target revenue shall be revised to correct for any errors in the calculation of the Annual Revenue Adjustment, Performance Incentive Adjustment, recorded adjusted revenues or other RBA accounting determinations (collectively "target revenue determinations") for any previous period and for revisions to Annual Revenue Adjustments or Performance Incentive Adjustments as a result of subsequent Commission orders that change the basis of previously calculated Annual Revenue Adjustments and/or Performance Incentive Adjustments. For any corrections of errors in previously calculated target revenue determinations, the target revenue shall be adjusted as of the date that the correct determinations would have been reflected in target revenue. For changes in the Annual Revenue Adjustment and/or Performance Incentive Adjustments as a result of subsequently issued Commission orders, the target revenue shall be adjusted as of the effective date of changes that are implemented pursuant to the subsequently issued Commission order.

The Commission and the Consumer Advocate will be notified of the target revenue revisions or corrections prior to implementation by the Company. There is no presumption that the target revenue changes are ultimately warranted or correct.

ORIGINAL SHEET NO. ____
Effective ____, 2020

REVENUE BALANCING ACCOUNT ("RBA") PROVISION (Continued)

On or before December 1 of the each year, the Company shall submit proposed revisions to Target Revenues to implement the Annual Rate Adjustment Provision, which revisions shall be effective the following January 1 in the absence of objections raised by the Consumer Advocate and approved by the Commission.

In the utility's comprehensive annual RBARA review transmittal ("RBARA Review Transmittal"), filed on or before March 31 of each year, the utility will have the burden to demonstrate that the ARA calculations and all other RBA entries for the previous calendar year are warranted and correctly applied or otherwise support any necessary revisions and corrections. The Consumer Advocate will provide comments regarding the changes with its Statement of Position. The RBA balance and RBA Rate Adjustment for the following year will reflect any appropriate modifications to the change made by the utility and approved by the Commission in the prior year if necessary.

Monthly Allocation Factors for the Target Revenue are as follows:

January	8.493%
February	7.673%
March	8.493%
April	8.219%
May	8.493%
June	8.219%
July	8.493%
August	8.493%
September	8.219%
October	8.493%
November	8.219%
December	<u>8.493%</u>
Total	100.000%

These factors are based on the number of days in each month, and remain subject to adjustment in any subsequent regulatory proceeding, if required by the Commission.

2. Balancing Account Entries:

Entries to the RBA will be recorded monthly. A debit entry to the RBA will be made equal to the target revenue as defined in Section A.1. above, times the appropriate monthly allocation factor in the table above. A credit entry to the RBA will be made equal to the recorded adjusted revenue. The recorded adjusted revenue is defined to include the electric sales revenue from authorized base rates, plus revenue from any authorized interim rate increase, plus revenue from any RBA rate adjustment (excluding the recovery of previously recorded RBA balance amounts therein), but excluding revenue for fuel and purchased power expenses, IRP/DSM, any Commission Ordered one-time rate refunds or credits or other surcharges, and adjusted to remove amounts for applicable revenue taxes.

ORIGINAL SHEET NO. ____
Effective ____, 2020

REVENUE BALANCING ACCOUNT ("RBA") PROVISION (Continued)

Interest will be recorded monthly to the RBA by multiplying the simple average of the beginning and ending month balance in the RBA, less deferred income taxes associated with the RBA balance, times the Interest Rate divided by 12. The Interest Rate shall be the short-term debt cost rate as established in deriving the consolidated cost of capital in the Company's last full rate case or other regulatory proceeding.

3. Recovery Of Balancing Account Amounts:

In its annual RBARA Review Transmittal, the Company will include a detailed statement of the monthly entries to the RBA balance during previous calendar supportive of the year-end balance in the RBA, along with supporting calculations.

Both an amortization of the previous calendar year-end balance in the RBA, adjusted for any Earnings Sharing Revenue Adjustments or any Performance Incentive Adjustment provided in accordance with the Performance Incentive Mechanism Provision and the Annual Revenue Adjustment will be recovered through a percentage rate adjustment, over the 12 months from August 1 of the current calendar year to July 31 of the succeeding calendar year. In the event the utility files for traditional test year rate relief based upon cost of service regulation, the recovery through the RBA Rate Adjustment of an Annual Revenue Adjustment shall terminate on the date of such filing.

Revisions to Target Revenue based on corrections for errors and subsequently issued Commission orders, described in Section A.1. above, will not be reflected in the RBA Rate Adjustment until a succeeding August 1 to July 31 period, unless otherwise ordered or approved by the Commission.

On or before March 31 of each year, the Company shall file with the Commission, the Consumer Advocate, and each party to the Company's most recent rate case proceeding or as otherwise directed by the Commission, an updated and comprehensive RBA Review Transmittal supporting the implementation of the RBA Provision, including RBA reconciliation, the ARA Provision, MPSR Provision and Performance Incentive Mechanism Provision, calculations supportive of Earnings Sharing Mechanism, determination and adjustments of target revenues, determination of the RBA Rate Adjustment; and documenting any errors, corrections and adjustments to Target Revenues in the preceding calendar year and prior to the transmittal date.

4. Revenue Balancing Account Rate Adjustment:

The RBA Rate Adjustment is comprised of the calculated values from Section A.3. above, adjusted to include amounts for applicable revenue taxes, and calculated as a percentage of base revenues over the RBA Rate Adjustment recovery period.

REVENUE BALANCING ACCOUNT ("RBA") PROVISION (Continued)

The RBA Rate Adjustment shall remain unchanged during the recovery period unless further modification is required by order or approval of the Commission, except as specifically provided above.

RBA Rate Adjustment

All Rate Schedules x.xx percent¹

5. Notice:

Notice of the annual Revenue Balancing Account Rate Adjustment filing shall be provided to all affected customers of the Utility in accordance with the provisions of this section by publication in newspapers of general circulation within 14 days and by including notification with its billing statements within 60 days after the Company makes its annual RBA Review Transmittal filing pursuant to this tariff. The notice to customers shall include the following information:

- a. A description of the proposed revision of revenues, including ARA, ESM and/or MPSR surcharges or credits;
- b. The effect on the rates applicable to each customer class and on the typical bill for residential customers; and
- c. The Company's address, telephone number and website where information concerning the proposed Revenue Balancing and Annual Revenue Adjustment may be obtained.

B: ANNUAL REVENUE ADJUSTMENT ("ARA") PROVISION:

1. Purpose: The ARA mechanism is subject to review and continuation, termination or modification by the Commission, upon a showing by the utility and finding by the Commission that continuation or modification is appropriate. The ARA mechanism is designed to determine the annual change in utility base revenue levels, determined by the index driven formula set forth below and defined herein.

2. ARA Formula: An Index-Driven revenue formula as set forth below:

$$\text{Annual Revenue Adjustment} = (\text{I-Factor}) - (\text{X-Factor}) + (\text{Z-Factor}) - \text{Consumer Dividend}$$

¹ RBA rate design is the subject of a pending settlement agreement in Docket No. 2018-0368, where the per-kWh recovery of RBA revenues would be revised to a percentage surcharge upon base revenues. This issue is expected to be resolved in the Commission's final Decision and Order.

REVENUE BALANCING ACCOUNT ("RBA") PROVISION (Continued)

Where,

I-Factor: Annual change in inflation based on estimated Gross Domestic Product Price Indicator ("GDPPI").

X-Factor: Predetermined annual productivity factor, initially set equal to "0.00%", subject to review and modification by the Commission.

Z-Factor: Factor applied (ex post) to account for exceptional circumstances and exogenous changes not in the utility's direct control.

Consumer Dividend: A "stretch factor" or reduction in allowed revenues stated as a percentage or fixed dollar amount.

If, through the application of this mechanism, it is determined that annual utility base revenues should be decreased or increased, the ARA will be applied within the RBA Provision.

The Company shall provide additional schedules supporting and documenting the ARA Adjustment using the methodology authorized herein.

3. Definitions:

- a. The ARA Adjustment shall be the change in the annual amount of base revenue determined by applying the ARA Factor to the prior year Target Revenues authorized in accordance with this tariff. The ARA Adjustment to revenues is to be recovered through the RBA Provision commencing on August 1 and over the subsequent 12 months through July 31, in the form of a preliminary abbreviated filing and subsequent comprehensive update as discussed in the Annual Evaluation Date.
- b. The ARA Factor is represented by the above formula wherein the Consumer Dividend may be stated as a percentage or as a fixed dollar amount, as determined by the Commission.
- c. Earnings Sharing Mechanism ("ESM") revenue surcharges or credits shall be the amounts to be recovered from or returned to customers through the RBA Provision, so as to implement the earnings sharing percentages and procedures described herein, commencing on August 1 of the calendar year containing the Annual Evaluation Date and over the subsequent 12 months after August 1.

4. I-Factor:

REVENUE BALANCING ACCOUNT ("RBA") PROVISION (Continued)

The Inflation Factor shall represent the annual change in inflation based on the consensus estimated annual change in the Gross Domestic Product Price Indicator ("GDPPI") to determine the ARA revenue adjustment for each year. The GDPPI escalation rate shall be the consensus projection published by the Blue Chip Economic Indicators (Aspen Publishing) that is available immediately preceding each December 1 for the current Annual Evaluation Date. In the event that the Blue Chip Economic Indicators forecast of the GDPPI for the following year is not available, the Consumer Advocate, Company, and Other Case Parties, with approval of the Commission, shall jointly select an alternative data source, or national economic index similar to GDPPI, as appropriate.

5. X-Factor:

The Productivity Factor is determined to be zero, subject to review and potential future modification by the Commission.

6. Consumer Dividend:

The Consumer Dividend is set at zero within the ARA, for separate crediting to customers as a one-time bill credit.

7. Z-Factor: Exogenous changes are events or actions that are beyond the control of utility management, having estimated incremental impacts upon annual utility revenue requirements (expenses and/or return on investment and depreciation, if applicable) in excess of \$4 million, limited to:

- a. changes in tax laws or regulations.
- b. remediation costs arising from named storms and other catastrophic events or losses, and
- c. Federal or State-declared emergencies, such as medical pandemics.

Qualifying Costs: In applying the specified cost limitations, the Company shall first defer all incremental non-labor costs and cost savings, including income taxes, non-labor O&M expenses, and depreciation of qualifying capital projects not otherwise recoverable through other cost tracking mechanisms authorized by the Commission that are incurred as a direct result of the exogenous event, amortizing such amounts over five years with such amortization commencing in the same year costs are incurred. Any deferred amounts shall be net of any related cost savings or other sources of cost recovery reasonably associated with the qualifying exogenous event.

Notification: Upon identification and accounting deferral of qualifying exogenous costs or cost savings, the Company shall submit a notice advising the Commission and the Consumer Advocate

REVENUE BALANCING ACCOUNT ("RBA") PROVISION (Continued)

of the incurrence of a qualifying change or event, and an explanation of the proposed recovery of deferred costs through the RBARA. The Utility shall subsequently file an application seeking RBA recovery of the deferred amounts and provide detailed supporting documentation to substantiate the existence of a qualifying event, demonstrate that the costs exceed the applicable threshold and document the reasonableness of the net amount sought for recovery. The Company shall timely respond to any requests for additional information relating to the qualifying change or event submitted by the Commission or the Consumer Advocate.

Evaluation: As part of the next following ARA filing or other application whereby recovery is sought, the Company shall provide detailed information and calculations supporting cost recovery, identifying the qualifying change or event, and demonstrating the reasonableness of the deferred costs. Complete, indexed workpapers and electronic files supporting the Z-Factor Adjustment shall be provided to the Commission, the Consumer Advocate and Other Case Parties if any, coincident with the application seeking cost recovery approval.

Recovery: Qualifying incremental costs that have been incurred, including qualifying costs deferred and amortized, shall be recoverable only upon approval by the Commission, as a component of target revenues. Z-factor cost recovery shall be conditioned upon demonstration by the utility that its incremental Z-factor costs were not offset by cost reductions experienced elsewhere in the business. The Commission shall consider both utility and customer impacts from qualifying events and may grant partial Z-factor recovery of qualifying costs in order to mitigate unacceptable customer impacts.

8. Consumer Dividend:

Pursuant to Commission Decision and Order 36326 at 31, "Consistent with the Principle of adopting a customer centric approach, including a Consumer Dividend will help ensure that 'day-one' savings for utility customers are realized." However, with the inclusion of a one-time bill credit to customers, the ARA input for Consumer Dividend is set to zero.

C. EARNINGS SHARING MECHANISM ("ESM") PROVISION:

For ESM purposes, the Company shall submit, for the twelve-month period ending December 31 of each year preceding the comprehensive March 31 ARA update filing, the following Schedules used to calculate and implement earnings sharing:

1. The Company's recorded actual average net plant in service, accumulated deferred income taxes, inventory, working capital, and other rate base components. The schedules shall also show the utility's actual depreciation expense, operating and maintenance expense, income taxes, taxes other than income

REVENUE BALANCING ACCOUNT ("RBA") PROVISION (Continued)

taxes, and other components of income for return, revenues, and actual capital structure, cost of debt, overall cost of capital, and return on common equity in the format set forth in the final order establishing the Company's latest effective rates. The Authorized Return on Equity ("ROE") shall be the percentage rate of return on equity capital approved by the Commission in the last issued Decision & Order in the Company's most recent test year general rate case or other regulatory decision of the Commission.

2. All applicable accounting and pro forma adjustments historically required in annual reports filed with the Commission, including all adjustments required to fully recognize the revenues and costs associated with achieved performance levels and all related revenue incentives and penalties or shared savings resulting from such performance.
3. Pro-forma adjustments to remove from recorded revenues any out-of-period ESM surcharges or credits recorded during the Evaluation Period.
4. A calculation comparing the achieved return on average common equity to the following earnings sharing grid, and indicating the Earnings Sharing Revenue surcharge or credit that should be recorded within the Revenue Balancing Account to effect the prescribed sharing of earnings below or above the most recent Commission-approved ROE levels:

Width of Deadband (no sharing)	Plus / Minus 200 basis points of approved ROE
Next 100 basis points (one percent) of ROE	25% share to/from customers
Next 100 basis points (one percent) of ROE	50% share to/from customers
All ROE beyond 400 basis points (four percent) of ROE	90% share to/from customers

5. Specific procedures for calculating earnings, rate base, updated cost of debt and ROE have been developed and used in decoupling transmittals approved by the Commission in all recent years.

D. RBA, ARA AND ESM EVALUATION PROCEDURES:

1. Complete, indexed workpapers and electronic files supporting the previous year-end balance in the RBA and target revenue determinations, the ARA revenue adjustment and ESM sharing surcharges or credits shall be provided to the Commission, the Consumer Advocate and Other Case Parties, if any, coincident

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REVENUE BALANCING ACCOUNT ("RBA") PROVISION (Continued)

with the comprehensive update filing on March 31. The Company will be prepared to provide information as may be requested to ensure adequate review by the Commission, Consumer Advocate, and Other Case Parties. The Consumer Advocate, Other Case Parties, and other interested persons may propose any adjustments determined to be required to bring the schedules into compliance with the above provisions and will work collaboratively to reach agreement on any proposed adjustments.

2. The ARA revenue adjustment, ESM, and any prior year revenue adjustments shall be recalculated for errors in prior calculations and for subsequent Commission orders that change the basis of prior calculations. The effect of such changes shall be implemented as described in the Revenue Balancing Account Provision.
3. As described in Sections 16-601-61 and 16-601-111 of the Hawaii Administrative Rules, Title 6, Chapter 61, based upon the Company's filed schedules and in the absence of any protests submitted by the Consumer Advocate, Other Rate Case Parties, or other interested persons, not later than 15 days before the June 1 effective date of the RBA Rate Adjustment described in the RBA Provision tariff, the RBA Rate Adjustment incorporating the ARA revenue adjustment, ESM surcharges or credits, and MPIR changes shall go into effect on the August 1 effective date, and the Commission shall confirm the commencement of the RBA Rate Adjustment in its monthly Tariff Order.

E. COMMISSION'S AUTHORITY:

The Commission may suspend any or all parts of the Revenue Balancing and Annual Revenue Adjustment provisions. Such suspension shall remain in place until removed by Commission Order.

F. TARGET REVENUE CURRENTLY IN EFFECT:

[table omitted]

G: HISTORICAL REFERENCE:

[table omitted]

Performance Based Regulation - Docket No. 2018-0088
Customer Dividend Calculation - Consumer Advocate First Updated Proposal

Annual Target Revenues Subject to ARA	Amount \$000	Value of 2 %	Times 5/12 Per Year	Times 4 Years Advanced	Approximate Residential Bill Impact
	Note 1	Note 2	Note 3	Note 4	Note 5
Hawaiian Electric Company	\$ 660,894	\$ 13,218	\$ 5,507	\$ 22,030	\$ 22.10
Hawaii Electric Light	157,075	3,142	1,309	5,236	\$ 28.50
Maui Electric Company	154,884	3,098	1,291	5,163	\$ 26.40
Total	\$ 972,853	\$ 19,457	\$ 8,107	<u>\$ 32,428</u>	

Footnotes:

- 1 Amounts proposed in decoupling filings, Schedule B1, to be effective June 1, 2020.
- 2 The projected GDPPI increase used in the 2020 decoupling filings was 1.9% and is rounded to 2 percent.
- 3 Making ARA effective on January 1 represents a five month acceleration of the current RAM effective date on June 1 of each years. The value each year is estimated to be 5/12 of one year of ARA.
- 4 Funded in advance by shareholders, with ratepayers responsible for the ARA acceleration in all subsequent years. Customer Dividend is equal to cumulative value of first 4 years acceleration.

5 Bill Impact Assumptions	Residential %	# of Customers
HECO-2708, HECO-402	27%	273334
HELCO-2317, HELCO-302	41%	74655
MECO-2333, MECO-302 Maui	31%	61214

Performance Based Regulation - Docket No. 2018-0088

Cost of Capital Updating Alternative (Illinois Statutory Methodology)

The Consumer Advocate does not believe it necessary to update or adjust for the cost of capital that is embedded within existing target revenues for future changes in capital market conditions or the allowed return on common equity. These issues can be fully considered at the end of the Control Period, when all PBR issues are reviewed by the Commission, including the adequacy of target revenue levels and MRP terms at that time. Additionally, the revenues allowed to the utilities should not be changed on a single-issue, piecemeal basis for changes in the cost of capital, while the many other elements of the overall revenue requirement are not being considered and updated. **However, if the Commission concludes that some systematic adjustment is necessary to reflect significant changes in the market cost of capital, the Consumer Advocate suggests making formulistic changes to the midpoint of the ESM sharing grid, rather than to target revenues.** This approach avoids piecemeal ratemaking issues, potentially adverse rate impacts and the complexity and controversy that is likely to arise in changing revenues periodically for cost of capital effects, while acknowledging changing capital market conditions that could impact the utilities' financial integrity if not addressed.

The midpoint of the ESM sharing grid could be linked to a widely available published capital market cost index. For illustrative purposes, we look to the formula ratemaking approach required by statute in Illinois, where the cost of equity is set equal to the average yields of 30-year U.S. Treasury bonds published by the Board of Governors of the Federal Reserve System in its weekly H.15 Statistical Release or successor publication, plus 580 basis points (5.8%). This average yield rate in calendar 2018 was 3.11%, which in comparison to the 9.50% ROE currently authorized for the Hawaiian Electric Companies, would imply a larger "spread" of 639 basis points. An appropriate ROE for Hawaii Electric Light Company is pending a determination by the Commission in Docket No. 2018-0368 where this "spread" calculation could be updated using average treasury yield values for 2019, if the Illinois method were used to adjust ESM calculations prospectively.

The following narrative describes the Illinois methodology in greater detail:

Alternative Formula Ratemaking in Illinois, for electric utilities participating in the Electric Infrastructure Modernization Act ("EIMA") program, provides for annual updating of the Cost of Equity pursuant to 220 ILCS 5-16-108.5(c)(3)(A) which provides as follows:

The performance-based formula rate shall be implemented through a tariff filed with the Commission consistent with the provisions of this subsection (c) that shall be applicable to all delivery services customers. The Commission shall initiate and conduct an investigation of the tariff in a manner consistent with the provisions of this subsection (c) and the provisions of Article IX of this Act to the extent they do not conflict with this subsection (c). Except in the case where the Commission finds, after notice and hearing, that a participating utility is not satisfying its investment amount commitments under subsection (b) of this Section, the performance-based formula rate shall remain in effect at the discretion of the utility. The performance-based formula rate

approved by the Commission shall do the following:

(1) Provide for the recovery of the utility's actual costs of delivery services that are prudently incurred and reasonable in amount consistent with Commission practice and law. The sole fact that a cost differs from that incurred in a prior calendar year or that an investment is different from that made in a prior calendar year shall not imply the imprudence or unreasonableness of that cost or investment.

(2) Reflect the utility's actual year-end capital structure for the applicable calendar year, excluding goodwill, subject to a determination of prudence and reasonableness consistent with Commission practice and law. To enable the financing of the incremental capital expenditures, including regulatory assets, for electric utilities that serve less than 3,000,000 retail customers but more than 500,000 retail customers in the State, a participating electric utility's actual year-end capital structure that includes a common equity ratio, excluding goodwill, of up to and including 50% of the total capital structure shall be deemed reasonable and used to set rates.

(3) Include a cost of equity, which shall be calculated as the sum of the following:

(A) the average for the applicable calendar year of the monthly average yields of 30-year U.S. Treasury bonds published by the Board of Governors of the Federal Reserve System in its weekly H.15 Statistical Release or successor publication; and

(B) 580 basis points.

At such time as the Board of Governors of the Federal Reserve System ceases to include the monthly average yields of 30-year U.S. Treasury bonds in its weekly H.15 Statistical Release or successor publication, the monthly average yields of the U.S. Treasury bonds then having the longest duration published by the Board of Governors in its weekly H.15 Statistical Release or successor publication shall instead be used for purposes of this paragraph (3).

In the most recent "round" of annual rate filings, this translated into an authorized ROE for the historical 2018 year of 8.91%, adding the statutory 5.80% to the average yield on 30-year treasury bonds reported in 2018 of 3.11%. Commonwealth Edison Company and Ameren Illinois Company will be authorized an 8.91% ROE within formula electric distribution rates to be charged in 2020, based upon this methodology.

The data employed in Illinois for ROE updating each year is available for download from the U.S. Treasury Department at: <https://www.federalreserve.gov/datadownload/Choose.aspx?rel=H15>

When 30-Year Treasury historical data monthly averages are selected, the following graphic summary can be developed for the period January 2010 through September 2019:



Consumer Advocate PBR Financial Projections

The Consumer Advocate has not updated for presentation its Short-term Financial Model that was included as CA Exhibit 4 to its January 15, 2020 First Updated Proposal. An update of financial modeling assumptions, inputs and scenarios is anticipated to be submitted with the Consumer Advocate's Statement of Position.

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MAJOR PROJECT SPECIAL RECOVERY ("MPSR") PROVISION

Supplement To:

Revenue Balancing and Annual Revenue Adjustment ("RBARA")

All terms and provisions of the Revenue Balancing and Annual Revenue Adjustment tariff are applicable, except that the total Target Revenue amounts for each billing period therein shall be adjusted to include Major Project Special Recovery amounts within Target Revenues in accordance with Commission orders specifying the allowed recovery amount and accrual dates, as summarized in Section E, below.

A: PURPOSE:

The purpose of the Major Project Special Recovery ("MPSR") Provision is to include within Target Revenues in the Revenue Balancing and Annual Revenue Adjustment discrete cost recovery for qualifying Major Projects found to be reasonable and explicitly allowed by order of the Commission, including: 1) the amounts of Commission-approved net annual revenue requirements, incremental operating and maintenance expenses incurred (or deferred and amortized), return on investment, depreciation/amortization and associated income and revenue taxes for qualifying Major Projects that meet the evaluation criteria specified herein, reduced by 2) cost savings arising from and enabled by the qualifying Major Project as well as any cost recovery that is provided under other effective tariffs.

B: DEFINITIONS:

For the purpose of the MPSR, the following definitions apply:

"Commission" means the Public Utilities Commission of the State of Hawaii.

"Complex projects" are projects that materially affect numerous aspects of the utility's operations, costs and/or earnings.

"Costs" means, inclusively, costs associated with return on and recovery of capital investment and/or operating and maintenance expenses and associated income and other taxes.

"Electric utility" or "utility" means a provider of electric utility service that is regulated by and subject to the Commission's jurisdiction pursuant to Chapter 269, HRS.

MAJOR PROJECT SPECIAL RECOVERY ("MPSR") PROVISION

"Eligible Projects" are Major Projects, as defined below, that are eligible for application and approval for special revenue recovery through the MPSR Provision as provided herein.

"Evaluative Criteria" are the identified issues to be addressed in applications submitted by the Utility seeking MPSR recovery.

"Major Project" means a resource plant addition or contractual expense obligations and/or deferred and amortized non-labor expenses totaling in excess of \$2.5 million, including any projects subject to application and Commission approval in accordance with the applicable provisions of the Commission's General Order No. 7.

"MPSR adjustment" means an adjustment to the utility's target revenues effectuated through the utility's Revenue Balancing and Annual Revenue Adjustment tariff, determined in accordance with the qualification and evaluation criteria described herein.

"MPSR adjustment mechanism" means the provisions for recovery of Major Project costs, net of cost savings, as provided for in these guidelines.

"REIP" means the Renewable Energy Infrastructure Program.

"RBARA" means the Revenue Balancing and Annual Revenue Adjustment provisions established by the utility's RBARA tariff.

"RPS" or "Renewable Portfolio Standard" is defined as set forth in HRSS 269-92. "Renewable energy" is defined as set forth in HRSS 269-91.

"Target Revenues" means the total amount of Commission-approved revenues that are subject to reconciliation through the Revenue Balancing and Annual Revenue Adjustment ("RBARA").

MAJOR PROJECT SPECIAL RECOVERY ("MPSR") PROVISION

C: ELIGIBLE PROJECT APPLICATIONS:

Major Projects that are eligible for review by the Commission and that may be approved for special recovery through the MPSR are transformative in nature and are not routine replacements of existing equipment or systems with like kind assets, relocations of existing facilities, restorations of existing facilities, or other kinds of business-as-usual investments. Transformative eligible investments include, without limitation, the following examples:

- (a) Infrastructure that is necessary to connect renewable energy projects. Infrastructure projects such as transmission lines, interconnection equipment and substations, which are necessary to bring renewable energy to the system. For example, renewable energy projects, such as wind farms, solar farms, biomass plants and hydroelectric plants, not located in proximity to the electric grid must overcome the additional economic barrier of constructing transmission lines, a switching station and other interconnection equipment. Building infrastructure to these projects will encourage additional renewable generation on the grid.
- (b) Projects that make it possible to accept more renewable energy. Projects that can assist in the integration of more renewable energy onto the electrical grid. For example, new firm generation or modifications to firm generation to accept more variable renewable generation or energy storage and pumped hydroelectric storage facilities that allow a utility to accept and accommodate more as-available renewable energy.
- (c) Projects that encourage clean energy choices and/or customer control to shift or conserve their energy use. Projects that can encourage renewable choices, facilitate conservation and efficient energy use, and/or otherwise allow customers to control their own energy use. For example, smart meters would allow customers to monitor their own consumption and use of electricity and allow for future time-based pricing programs. Systems such as automated appliance switching would provide an incentive to customers to allow a utility to mitigate sudden declines in power production inherent in as-available energy.

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MAJOR PROJECT SPECIAL RECOVERY ("MPSR") PROVISION

- (d) Approved or Accepted Plans, Initiatives, and Programs. Capital investment projects and programs, including those transformational projects identified within the Companies' ongoing planning and investigative dockets, as such plans may be approved, modified, or accepted by the Commission, and projects consistent with objectives established in investigative dockets.
- (e) Utility Scale Generation. Electric utilities may seek recovery of the costs through the MPSR provision for utility scale generation that is renewable generation or a generation project that can assist in the integration of more renewable energy onto the electrical grid.
- (f) Grid Modernization projects. Projects such as smart meters, inverters, energy storage, and distribution automation to enable demand response.

In Applications seeking approval for cost recovery through the MPSR Provision, the electric utility bears the burden of proof that all Major Project costs proposed for MPSR treatment meet the criteria specified herein. If a Major Project includes costs for both transformative activities associated with the Eligible Project, as described above, as well as characteristics of routine replacement, relocation or other business-as-usual work, only that portion of the Major Project costs reasonably attributed or allocated to transformative work shall receive MPSR cost recovery.

Application for recovery of revenues through the MPSR Provision can be made in conjunction with and as part of an application pursuant to General Order No. 7, to the extent General Order No. 7 is applicable to the Major Project.

Costs eligible for the MPSR Provision recovery include:

- (i) Return on the net of tax average annual undepreciated investment and/deferred non-labor expenses approved to be treated as assets in allowed Eligible Projects costs for each Major Project, at the rate of return to be determined in the review of each Eligible Major Project application, as approved by the Commission, except that in the initial year in service, the average investment or deferred cost regulatory asset balance shall be the simple average of the balance at the in-service date and the balance at the end of the initial year;
- (ii) Recorded depreciation and regulatory asset amortization accruals (at a rate and methodology to be determined in review

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MAJOR PROJECT SPECIAL RECOVERY ("MPSR") PROVISION

of each project's application, and as approved by the Commission) to begin on the following January 1st after the month of the in-service date of the Project; and

- (iii) Other relevant costs, non-labor operations and maintenance expenses), and applicable taxes, reduced by offsetting cost savings, as approved by the Commission.

Costs recovered through the MPSR Provision shall be offset by all known and measurable operational net savings and benefits resulting from the Eligible Project(e.g., accumulated depreciation and accumulated deferred income tax reserves, reductions in operating and maintenance expenses, related additional revenues, etc.) to the extent such savings or benefits are not passed on to ratepayers through energy cost or other adjustment clause mechanisms, and to the extent that such savings or benefits can reasonably be quantified. Net savings and benefits shall be offset as they are realized to the extent feasible.

A business case study shall be submitted with each application identifying and quantifying all operational and financial impacts of the Eligible Project and illustrating the cost/benefit tradeoffs that justify proceeding with the project to the extent that such impacts can reasonably be determined. The submitted detailed business case study shall cover all aspects of the planned investments and activities, indicating all expected costs, benefits, scheduling and all reasonably anticipated operational impacts. The business case shall reasonably document and quantify the cost/benefit characteristics of the investments and activities, indicating each criterion used to evaluate and justify the project, including consideration of expected risks and ratepayer impacts. The business case should also clearly outline how it will advance transformational efforts with appropriate quantifications, to the extent such quantifications can reasonably be determined.

A detailed schedule and budget for each element of the planned investments, expenses and activities shall be submitted, quantifying any contingencies, risks, and uncertainties, and indicating planned accounting and ratemaking procedures and expected net customer impacts.

Applications must state the specific criteria that are proposed for determination of used and useful status of the project, to ensure that no costs are deferred or recovered for new assets or deferred non-labor expenses that are merely commercially available, but are not being used to provide service to ratepayers.

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MAJOR PROJECT SPECIAL RECOVERY ("MPSR") PROVISION

Recoverable costs shall be limited to the lesser of actual net incurred project/program costs or Commission-approved amounts, net of savings.

Complex projects may be eligible for recovery through the MPSR adjustment mechanism, when supported by sufficient detailed business case analysis and documentation of reasonably quantifiable expected impacts, costs and benefits resulting from such projects.

Parties to the proceedings on the applications for recovery of costs through the MPSR Provision shall endeavor to complete procedural steps to allow for approval of the application within seven months of the date of application. The Companies acknowledge that the procedural schedule for MPSR for complex projects may take longer than projects that do not affect numerous aspects of the utility's operations.

D: EVALUATIVE CRITERIA:

Applications seeking Commission approval for Major Project Special Recovery and adjustments to Target Revenues shall be evaluated by the Commission for reasonableness and prudence, including consideration without limitation of the following evaluative criteria. The Utility shall address each of the following Evaluative Criteria for each Major Project where MPSR cost recovery is proposed:

1. Is the Major Project eligible for MPSR recovery, in conformance with Section C of this tariff?
2. Does the Major Project represent a cost-effective solution to utility business needs, providing benefits commensurate with estimated costs, at acceptable levels of risk?
3. Does the Major Project provide net customer value and enhance the affordability of energy services?
4. Is the Major Project the most advantageous approach among available resource planning alternatives, including consideration of contract services and potential non-wires alternatives?
5. Are the benefits arising from the Major Project transformative in nature, rather than reflective of traditional utility investment and operational activities and/or routine replacements or upgrades of facilities?
6. Are the proposed Major Project costs proposed for MPSR recovery reasonable in amount and fully offset by all quantifiable expected benefits and cost savings arising from the Major Project that do not flow through the Energy Cost Recovery Mechanism, Purchased Power Adjustment Clause or other tariff provisions?

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MAJOR PROJECT SPECIAL RECOVERY ("MPSR") PROVISION

7. Are reasonable in-service and used and useful conditions proposed for the Major Project to determine an accrual date for MPSR revenues?
8. Are the costs of the types of investments or expenses associated with the Major Project being recovered through base rates, the REIP or any other cost recovery mechanism or tariff surcharge?
9. Have reasonable risk mitigation, asset acceptance criteria, progress reporting and management procedures been proposed for the Major Project?

No Major Project Special Recovery shall be included within Target Revenues until explicitly approved in amount at specified accrual dates in a Commission order.

E: MAJOR PROJECT SPECIAL RECOVERY APPROVED TARGET REVENUES:

The following table summarizes the approved revenue accrual dates and amounts for each Major Project, by applicable Commission order:

MAJOR PROJECT	DOCKET/ORDER	ACCRUAL DATE	TARGET REVENUE
CUMULATIVE TOTAL			\$XXXX

F. COMMISSION'S AUTHORITY

The Commission may suspend any or all parts of this Major Project Special Recovery Provision or revise the Accrual Dates or Target Revenues approved in previous orders. Such suspension or revisions shall remain in place until removed by Commission Order.

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing **DIVISION OF CONSUMER ADVOCACY'S SECOND PROPOSAL UPDATE FOR PHASE 2** was duly served upon the following parties electronically to the e-mail addresses below pursuant to HAR § 16-601-21(d), as modified by Order No. 37043 Setting Forth Public Utilities Commission Emergency Filing and Service Procedures Related to COVID-19, filed on March 13, 2020.

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DATED: Honolulu, Hawaii, May 13, 2020.

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FILED

2020 May 13 PM 16:07

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The foregoing document was electronically filed with the State of Hawaii Public Utilities Commission's Document Management System (DMS).